

INSURANCE LAW IN MALAYSIA

by

NIK RAMLAH BINTI NIK MAHMOOD

Faculty of Laws

Queen Mary College, London.

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ABSTRACT

It is generally assumed that by virtue of s.5 of the Civil Law Act 1956 (Malaysia), which deals with the application of English law, the law of insurance in Malaysia follows strictly the law of England either as it stood on 7 April 1956 (for the states of Johore, Kedah, Kelantan, Negri Sembilan, Pahang, Perak, Perlis, Trengganu and Selangor) or as it stands currently (for the states of Penang, Malacca, Sabah and Sarawak). Whilst this is essentially correct, there are several factors which result in the development and application of some divergent principles.

This thesis seeks to trace the general body of insurance law which has developed in Malaysia. It starts with a historical account of the insurance industry in the country. This is followed by ten chapters dealing with the main aspects of the substantive law. In these chapters, an attempt is made to highlight any noticeable departure from the statute law or common law of England. Such a departure may be due to the fact that the relevant law in Malaysia differs from that in England, for example the provisions of the Contracts Act 1950 (Malaysia) in relation to contractual formalities. Again, the provisions of the Insurance Act 1963 (Malaysia) in

relation to insurable interest differ from the English common law. Moreover, Malaysian judges have interpreted and applied the common law in ways which do not always mirror English developments. Even where there are almost identical statutory provisions, such as those in relation to trusts of life policies, there may be problems which are unique to Malaysia because of the different personal laws of its peoples.

The next chapter deals with Compulsory Third Party Motor Insurance which is the most important branch of general insurance in the country. The thesis then describes the introduction of a parallel system of insurance, ie. the Islamic system of insurance in the country, a development in Malaysia and a few other Muslim countries. The final chapter looks at how Malaysia, as a developing country, regulates its insurance industry.

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CHAPTER ONE

GENERAL INTRODUCTION

1.0 Malaysia - A Historical Background

Malaysia is a federation of thirteen states; eleven in Peninsula or West Malaysia, two in North Borneo or East Malaysia and includes the Federal Territories of Kuala Lumpur, the capital, and Labuan, an island off the coast of East Malaysia. It covers an area of 332,952 square kilometres and has a population of about 15 million.

The written history of Malaysia dates from the fourteenth and fifteenth centuries, during the period of the Malacca Sultanate. Commercial links between the Malay Peninsula, particularly Malacca, and the trading centres in India and Arabia flourished during this period, resulting in the advent of Islam, which is now the state religion.

The Portuguese capture of Malacca in 1511 marked not only the demise of the Malacca Sultanate but also the beginning of European incursion into the country. Portuguese rule in Malacca was replaced by the Dutch in 1641. This was followed in 1675 by a period of alternate British and Dutch rule until 1824 when the Dutch finally ceded Malacca to the British under the terms of the Anglo-Dutch Treaty of 1824.

It was the search for a suitable shipping base along the Straits of Malacca for the lucrative Sino-British trade that brought the British officially into the country in the 18th century although British and other European individuals were already trading in Malacca since the 15th century¹. Francis Light occupied the island of Penang on behalf of the East India Company in 1786, hoping that it would serve as such a base. The unsuitability of Penang coupled with the problems posed by the Dutch in Malacca led Stamford Raffles to search for an alternative base. In 1819 he landed on the island of Singapore and promptly brought it under British rule.

In 1826, Penang, Malacca and Singapore were brought together to form the colony of the Straits Settlements². Administration of this colony was first carried out from India but in 1867 it was put directly under the Colonial Office in London³.

The other Malay states were then ruled by independent Malay rulers. The development of the tin mining industry

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1. Braddel, R, The Law of the Straits Settlements, A Commentary, Oxford University Press, Kuala Lumpur 1982, pp.1-2.
 2. 6 Geo. IV c.85, s.21. See also Turnbull, CM, The Straits Settlements 1826-67, University of London Athlone Press, London 1972.
 3. Government of Straits Settlements Act, 29 & 30 Vict. c.115 and Letters Patent dated 28th December 1866.

particularly in the states of Perak and Selangor, coupled with the constant bitter feuding between the immigrant Chinese miners and the Malay rulers and their chiefs over the collection of revenue from tin, caused concern among the British as the economy of the Straits Settlements was threatened. This ultimately motivated them to extend their power and influence into the four more economically developed states of Perak, Selangor, Pahang and Negri Sembilan, by the introduction of a British Resident in each state⁴. In 1896 these states formed the Federated Malay States, a single British Protectorate headed by the British High Commissioner⁵.

The other states of Johore, Kedah, Kelantan, Perlis and Trengganu were subsequently brought under British tutelage as independent British Protectorates with a British Adviser in each state. Together they were loosely called the Unfederated Malay States.

The Straits Settlements, the Federated and the Unfederated Malay States existed as three separate entities each with varying degrees of British control

4. Perak was the first state to have such a Resident after the Pangkor Engagement of 1874. This was followed in the same year by Selangor and Sungei Ujong (now part of Negri Sembilan), Pahang in 1888 and Negri Sembilan in 1889.

5. Treaty of the Federation of 1st July 1896.

and influence, until the outbreak of the Second World War and the subsequent Japanese Occupation of the entire Malay Peninsula in 1941. After the surrender of the Japanese in 1945, the three entities were placed under the British Military Administration. In 1946, faced with new economic and political challenges, the British brought the Straits Settlements to an end. Penang and Malacca were joined to the Federated and the Unfederated Malay States to form the Malayan Union⁶ while Singapore was made a separate colony.

Opposition to the Malayan Union from the Malays led to its abandonment in 1948 and the formation of the Federation of Malaya, a Federation of all the Malay States together with Penang and Malacca⁷. The Federation obtained its independence in 1957 while Singapore was granted full internal self-government in 1959⁸.

Sarawak, in East Malaysia, was part of the dominions of the Sultan of Brunei until 1841 when it was ceded to James Brooke who became its first white ruler. The Brooke

6. Malayan Union Order-in-Council, [1946] 1 Stat. Rules and Orders 543 (No.463).
7. Federation of Malaya Order-in-Council [1948] 1 Stat. Instr. 1231 (No.108) and Federation of Malaya Agreement 1948.
8. Federation of Malaya Independence Act 1957, 5 & 6 Eliz. II c.60, Federation of Malaya Order-in-Council [1957] 1 Stat. Instr. 832 and Singapore (Constitution) Order-in-Council [1958] 2 Stat. Instr. 2156.

family governed the state as independent sovereigns until Sarawak was occupied by the Japanese in 1941. In 1946, after a brief period of British Military Administration, the Brooke family handed the state to the British Crown⁹.

Sabah, the other East Malaysian state, was also part of the dominions of the Sultan of Brunei. Formerly known as British North Borneo, it was carved out and ceded for the purpose of development to the British North Borneo Company in 1888 and remained as such until it too was occupied by the Japanese in 1941. Like Sarawak, it became a Crown Colony in 1946.

In 1963, the Federation of Malaya, Singapore, Sabah and Sarawak were joined together to form a single political entity - Malaysia¹⁰. In 1965 Singapore left Malaysia to be an independent city state¹¹.

Singapore was thus at times part of the Federation and at times out of it. It had been part of the Straits Settlements for ninety years. It then stood by itself until 1963 when it joined Malaysia and finally left in

9. For an account of Sarawak under the Brooke family, see Rawlins, J, Sarawak 1839 - 1963, Macmillan, London 1965.

10. Malaysia Act 1963 (Laws of Malaysia, Act 26).

11. Malaysia (Singapore Amendment) Act 1965, Constitution (Amendment) Act 1965 (Singapore) and Singapore Independence Act 1965.

1965. In spite of these political changes, Singapore remained throughout the commercial, financial and maritime capital not only of the entities of which it was a part, but also of the region as a whole. The history of the development of the insurance industry in Malaysia, like the history of all other commercial and financial sectors in the country, is inextricably linked with the developments in Singapore. Throughout this thesis, Singapore is considered to be a part of Malaysia until its final departure in 1965. Cases that were decided and other events which took place there prior to 1965 are considered to be part of the cases that were decided, and the events as events which took place, in Malaysia.

2.0 The Introduction and Application of English Commercial Law

English law was first introduced by statute in Penang in 1807 by the First Charter of Justice¹². It established a Court of Judicature in Penang which was to exercise all the jurisdiction of the English courts of law and Chancery 'as far as circumstances will admit'¹³. A second

12. Letters Patent dated 25th March 1807. As to the legal significance of this Charter, see Kamoo v Bassett (1808) 1 Ky. 1.

13. For the meaning of this phrase, see Sheridan, LA, The British Commonwealth; The Development of its Laws and Constitution; Malaya and Singapore, The Borneo Territories, Vol.9, Stevens, London 1961, p.3.

Royal Charter of Justice was granted in 1826¹⁴, extending the jurisdiction of the Court of Judicature to Singapore and Malacca. This statutorily introduced into Penang, Malacca and Singapore, English law as at 26th November 1826¹⁵.

After the transfer of the administration of the Straits Settlements from India to the Colonial Office in London in 1867, legislative authority within the Colony was delegated to the Legislative Council of the Straits Settlements. This Council passed the Civil Law Ordinance of 1878¹⁶ which marked the introduction of a considerable body of English commercial law into Malay. S.6 of this Ordinance provided that in all questions or issues which arose or which had to be decided with respect to certain specified areas of commercial law as well as with respect to mercantile law generally, the law to be administered would be the same as would be administered in England in the like case at the corresponding period. Among the areas specifically mentioned were marine insurance, average and fire and life insurance. This provision was retained when the 1878 Ordinance was replaced by the

14. Letters Patent dated 27th November 1826.

15. In the Goods of Abdullah (1835) 2 Ky. 8 and Rodyk v Williamson Unreported, see (1835) 2 Ky. 9 (Footnote).

16. Straits Settlements Ordinance No. IV of 1878.

Civil Law Ordinance 1909¹⁷. The Civil Law Enactment 1937¹⁸ of the Federated Malay States which was subsequently extended to the Unfederated Malay States in 1951¹⁹ had no specific provision for the reception of English commercial law. S.2 of the Enactment merely provided generally for the application of the common law of England and the rules of equity as administered in England at the commencement of the Enactment, subject to local statutory provisions or other modifications.

In 1956, a single Civil Law Ordinance²⁰ was introduced in the Federation of Malaya. This replaced both the Straits Settlements Ordinance and the Federated Malay States Enactment.

Statutory reception of English Law in Sarawak began in 1928 with the introduction of the Law of Sarawak Ordinance²¹. S.2 of this Ordinance provided that the law of England, in so far as it was not modified by state ordinances and to the extent permitted by native customs and local conditions, was to be applied. This Ordinance was repealed by the Application of Laws Ordinance 1949²²

17. Straits Settlements Ordinance No.VIII of 1909.

18. FMS Enactment No.3 of 1937.

19. Civil Law (Extension) Ordinance 1951 (FM Ordinance No.49 of 1951).

20. FM Ordinance No.5 of 1956.

21. Order No.L-4, 1928.

22. No.27 of 1949, now Cap. 2, Revised Laws of Sarawak, 1958.

which provided for the application of the common law, doctrines of equity and English statutes of general application, subject again to qualifications similar to those in the 1928 Ordinance²³.

English law was statutorily introduced in Sabah by the Civil Law Ordinance 1938²⁴. This was replaced by the Application of Laws Ordinance 1951²⁵ which contained a provision similar to that in the Sarawak Ordinance of 1949.

The Application of Laws Ordinances of both Sarawak and Sabah, like the Civil Law Enactment 1937 of the Federated Malay States, did not have specific provisions relating to the application of English commercial or mercantile law. It was only in 1972 when the Civil Law Ordinance 1956 of the Federation of Malaya was revised and extended to these two states²⁶ that there was a single statute providing for the reception of English law for the whole of Malaysia.

The application of English commercial law is provided for

23. Application of Laws Ordinance 1949, s.2.

24. No.2 of 1938.

25. No.27 of 1951, now Cap. 6, Laws of North Borneo, 1953.

26. Civil Law Act 1956 (Revised 1972) (Laws of Malaysia, Act 67).

by s.5 of the revised Act. There are separate provisions for Penang, Malacca, Sabah and Sarawak on one hand and the rest of the country on the other.

S.5(1) reads:

In all questions or issues which arise or which have to be decided in the states of Johore, Kedah, Kelantan, Negri Sembilan, Pahang, Perlis, Selangor and Trengganu with respect to the law of partnerships, corporations, banks and banking, principals and agents, carriers by air, land and sea, marine insurance, average, life and fire insurance, and with respect to mercantile law generally, the law to be administered shall be the same as would be administered in England in the like case at the date of coming into force of this Ordinance, if such question or issue had arisen or had to be decided in England, unless in any case other provision is or shall be made by any written law.

S.5(2) reads:

In all questions or issues which arise or which have to be decided in the states of Malacca, Penang, Sabah and Sarawak with respect to the law concerning any of the matters referred to in the last preceding subsection, the law to be administered shall be the same as would be administered in England in the like case at the corresponding period, if such question or issue had arisen or had to be decided in England, unless in any case other provision is or shall be made by any written law.

Prior to the extension of the Act to Sabah and Sarawak, s.5(2) was applicable only to Penang and Malacca. The fact that these two states were formerly part of the Crown Colony of the Straits Settlements must have accounted for the distinction between s.5(1) and s.5(2).

S.5 is not the only provision in the Act for the reception of English law, although it is the only one which deals specifically with commercial law²⁷. The provisions of s.5 clearly originated from s.6 of the Civil Law Ordinance 1878 of the Straits Settlements. The purpose of that provision was said to be 'to inspire confidence among merchants by assuring them that any question arising in regard to their commercial transaction will be decided as it would be decided at the corresponding period in England' unless local provisions existed²⁸.

The reference in s.5 to 'the law...as administered in England' rather than specifically to the common law, rules of equity and statutes of general application is perhaps due to the realisation that the use of the latter phrase could have prevented the importation of the Law Merchant and Maritime Law, which historically were not administered either by the Common Law Courts or the Courts of Chancery in England²⁹.

27. S.3 provides for the application of the common law of England and the rules of equity as administered in England, in West Malaysia, and for the application of the common law, rules of equity and English statutes of general application in Sabah and Sarawak, in the absence of local statutory provisions.

28. Seng Djit Hin v Nagurdas Purshotumdas & Co. (1921) 14 SSLR 181 at p.208, per Voules J.

29. Bartholomew, GW, The Commercial Law of Malaysia; A Study in the Reception of English Law, Malayan Law Journal Ltd., Singapore 1965, pp.33 - 34.

While there is no doubt that the 'law...as administered in England' includes English statutes³⁰, the conditions for their application are not entirely clear. All s.5 requires is that this must be in respect of an issue in the areas mentioned or in respect of mercantile law generally and that there are no local statutory provisions on that issue. The other requirement which is frequently found in such provisions - the suitability of the statute to local circumstances or the 'local circumstances proviso' - is not expressly mentioned in this section. The existence of such a proviso however is normally implied when an English statute is applied pursuant to this provision³¹.

In the Malay States, the law to be applied under s.5(1) is the law as administered in England on 7 April 1956 - the date the Act came into force in these states³². In Penang, Malacca, Sabah and Sarawak, according to s.5(2), the law to be applied is the law of England at the time the question or issue arises. In considering the significance of this difference, a distinction must be made between the common law and the rules of equity

30. In Mazzarol v United Oriental Assurance Sdn. Bhd., [1984] 1 MLJ 260, the Federal Court held that the Marine Insurance Act 1906 (UK) was applicable in the Malay States by virtue of s.5(1) of the Civil Law Act 1956.

31. Shaik Sahied bin Abdullah Bajera v Sockalingam Chettiar [1933] SSLR 101 (Court of Appeal) and (1933) 2 MLJ 81 (Privy Council).

32. Doris Rodrigues v Bala Krishnan [1983] 2 MLJ 77.

on one hand and English statutes on the other.

The principles of common law and the rules of equity are timeless, everlasting and dateless. They do not change through time but exist as a single whole in the future as they do today and as they did in the past. According to the declaratory theory of the common law, judges do not legislate, they merely expound or expand what the law has always been. As such, there cannot be a difference between s.5(1) and s.5(2) as far as the importation of the common law and rules equity are concerned.

It is only in relation to the application of English statutes that there can possibly be a distinction between the two sub-sections. The general trend of opinion³³

33. See eg. Sheridan, Op. cit., footnote 13, Wu, MA and Vohrah, B, The Commercial Law of Malaysia, Heinemann, Kuala Lumpur 1980, p.3, and Ibrahim, AM and Joned, A, Sistem Undang Undang di Malaysia, Dewan Bahasa dan Pustaka, Kuala Lumpur 1985, pp.89 - 90. In Singapore where there is a provision similar to s.5(2), the same view is held. See eg. Lee, CY, The Law of Consumer Credit, Singapore University Press, Singapore 1980, p.20 and Chan, HHM, An Introduction to Singapore Legal System, Malayan Law Journal Publishers, Singapore 1985, p.16. The assumption that such a provision allows for the continuing reception of English statutes in Singapore has in fact prompted the Singapore legislature to amend the said provision in 1979 by the Civil Law (Amendment) Act 1979 which provided inter alia that any law enacted in the UK giving effect to a treaty or international agreement to which Singapore is not a party, shall not be applicable. This amendment was thought necessary due to the possibility that statutes passed in the UK in compliance with EEC agreements could be applicable in Singapore by virtue of the existing provision.

seems to be that this distinction is real and that s.5(2) allows the continued reception of current English statutes in the four states mentioned. Any English statute however recent, which fits into the description in the provision would therefore be applicable in the four states.

There is however a weakness in the above interpretation. It seems to be against all theories of Constitutional Law that a statute passed in another country should be applicable in a country which has achieved its independence and set up its own sovereign legislature, without ever being formally adopted or even considered by that legislature.

When the prototype for s.5(2) was introduced in the form of s.6 of the Civil Law Ordinance 1878 of the Straits Settlements, that part of the country was a Crown Colony of England. Similarly when Penang and Malacca were joined with the other Malay States to form the Federation of Malaya, the Federation was a Protectorate within the British Commonwealth and was still such a Protectorate in 1956 when the Civil Law Ordinance was passed. The 'continuing reception' clause in this Ordinance as in the 1878 Ordinance could therefore be literally applied. The Federation of Malaya, including Penang and Malacca, however achieved full independence on 31 August 1957. The country now has a Constitution which is

supreme³⁴ and a Parliament which is the sole legislature for the country as a whole. As Parliament is completely independent of, and totally severed from, the Parliament of the United Kingdom, no part of the country should remain within the imperial legislative jurisdiction of the latter. There is something intrinsically wrong in a statutory provision which allows statutes passed in the United Kingdom after the birth of an independent nation and the setting up of an autonomous legislative body to be applied in that country³⁵. The concept of 'continuing reception' of English statutes can only be interpreted literally for as long as the legislative structure of the recipient country remains linked to the Parliament of the United Kingdom. For Penang and Malacca, the 'continuing reception' of English statutes under s.5(2) must be taken to refer only to statutes passed prior to 31 August 1957 - Malaysia's independence day. Sabah and Sarawak were both Crown Colonies before they joined the Federation on 23 September 1965. Hence only English statutes passed in the United Kingdom before that date could be applicable in these states under the same provision.

34. Federal Constitution, Art. 4(1).

35. A similar argument has been used, not in relation to s.5 but in relation to s.3 of the Civil Law Act which provides for the reception of English Law generally, see Bartholomew, Op. cit., footnote 29, pp.102 - 105. For a consideration of similar provisions in some African countries see Allot, A, New Essays in African Law, Butterworths, London 1970.

While writers seem to be unanimous in their view that s.5(2) literally allows for the continuing reception of English statutes in the four states, the courts have not made any definitive pronouncement on this issue. An opportunity to do so arose in Tan Chong & Sons Motor Co. (Sdn.) Bhd. v Alan McKnight³⁶ but the Federal Court judiciously avoided a decision on the issue. In this case the question arose as to whether the Sale of Goods Act 1893 (UK) or the Sale of Goods Act 1979 (UK) was applicable in Penang. At the High Court it was held that the latter was applicable by virtue of s.5(2) of the Civil Law Act. On appeal, the Federal Court declined to either confirm or contradict this finding. Accepting that English Law was applicable in Penang on the issue before them, the Federal Court did not decide which of the two Acts was in fact applicable. According to Salleh Abas FJ (as he then was):³⁷

[W]hatever English Act is applicable it is clear that in English Law before and after 1979, a buyer is entitled to rely upon an implied condition as to fitness of the goods for which he bought them provided of course he communicated to the seller the intended use of the goods and relied upon their judgement.

While the significance of the issue relating to the date

36. [1983] 1 MLJ 220.

37. Ibid. at p.230.

of reception of English statutes has been greatly reduced in most areas of commercial law by the introduction of local statutes which are applicable throughout the country³⁸, it remains a thorn in the flesh in areas like insurance where the bulk of the substantive law continues to be based on the common law and in areas like Sale of Goods where local legislation applies only in certain parts of the country³⁹.

Apart from specifically mentioning certain aspects of commercial law, s.5 also refers to 'mercantile law generally'. Whilst the main branches of insurance law namely Marine, Fire and Life are specifically mentioned, other areas such as Motor, Personal Accident and Liability Insurance come within the ambit of 'mercantile law generally',⁴⁰.

S.5 refers only to the substantive law applicable in the areas mentioned; it does not allow the application of English rules of procedure and evidence in these areas. Hence whilst allowing the application of English Law in the area of Marine Insurance for instance, s.5 does not

38. Eg. Contracts Act 1950 (Revised 1974) and Partnership Act 1961 (Revised 1974).

39. Eg. Sale of Goods (Malay States) Ordinance 1957.

40. In King Lee Tee v Norwich Union Fire Insurance Society Ltd. (1933) 2 MLJ 187 it was held that while the Road Traffic Act 1930 (UK) was not within the scope of this provision, the Third Party (Rights Against Insurers) Act 1930 (UK) was.

allow the use of English rule in relation to the discovery of a ship's papers in a claim upon a marine policy⁴¹.

3.0 The Growth of the Insurance Industry

3.1 Prior to the Arrival of the Western Concept of Insurance

Before the arrival of the Western colonial powers, the Malay States were governed by their respective rulers in accordance with Muslim Law in respect of personal and family matters and in accordance with Malay Customary Law⁴² in respect of all other matters.

Two different varieties of Malay Customary Law were applicable then. In Negri Sembilan it was the Adat Pepatih which was brought into the country by Malays from the Minangkabau region of Sumatra. In the other states, the Adat Temenggong, brought by Malays from the Palembang region of Sumatra, was followed. Some of the states had their own Codes which were based on either of these laws. The well-known Codes included the Maritime Code of

41. Mohamed Sultan Maricar v Prudential Assurance Co. Ltd. (1941) 10 MLJ 26.

42. For the sources and legal significance of Malay Customary Laws, see Hooker, MB, 'A Note on Malayan Legal Digest', (1968) 41 JMBRAS 157.

Malacca⁴³, the Ninety-Nine Laws of Perak⁴⁴ and the Laws of Johore⁴⁵.

In Sabah and Sarawak, the Customary Law is based on the practices and customs of the different native tribes. These Laws are more developed and they still play an important role in the legal systems of the two states⁴⁶.

The concept of insurance in its western form cannot be traced in any of these laws. There survives till today, however a Malay custom whereby members of a community make voluntary monetary or other contributions to the bereaved family of a deceased person in order to lessen their suffering and help with the funeral and other expenses. The fact that the loss of one is shared by other members of the community, albeit voluntarily, seems at the very basic level to resemble the concept of insurance. This however is more of an accepted practice rather than a strict principle of Customary Law and hence

43. 'The Maritime Codes of the Malays', Reprinted from a translation by Sir Stamford Raffles, (1879) 3 JSBRAS 62.

44. Rigby, J, 'The Ninety-Nine Laws of Perak', in Papers on Malay Subjects, Wilkinson and Rigby (Eds.), FMS Government Press, Kuala Lumpur 1908, p.1.

45. Logan, JR, 'A Translation of the Malayan Laws of the Principality of Johore', in Readings in Malay Adat Laws, Hooker, MB, (Ed.), Singapore University Press, Singapore 1970, p.83.

46. See generally, Hooker, MB, Native Law in Sabah and Sarawak, Malayan Law Journal Ltd, Singapore 1980.

is not mentioned in any of the Malay Codes. There are however several provisions in the Codes on how certain types of losses were to be shared - not by the community as a whole but between persons having an interest in a particular subject matter or adventure. These laws seem to have drawn a distinction between losses that were intentionally caused and those that resulted from fortuitous events⁴⁷. While the former must be borne by the party at fault, the latter was to be shared equally by all parties having an interest in the subject matter or the adventure. These parties must bear the consequences of such a loss because there was no means by which the risk of losses from such events could be transferred to a third party.

The Native Customary Laws of Sabah and Sarawak deal mainly with family and land matters. Similarly, Muslim Law as applicable throughout the country deal exclusively with the personal laws of Muslims. As such, neither has principles relating to loss sharing or other matters even remotely resembling the western idea of insurance.

47. Eg. according to the Maritime Codes of Malacca (Op. cit footnote 43), if during heavy seas or high winds a boat hit another or struck a rock, it would not be considered as an accident but as a fault, because under such conditions the vessel should not have been at sea. The loss was to be divided in three parts, one to be borne by the person to whom the damaged boat belonged and the other two parts by the persons who were responsible for the loss.

3.2 The Arrival of the Western Concept of Insurance

The western concept of insurance was formally introduced in Malaysia in the first half of the 19th century primarily through the Agency Houses⁴⁸ which acted as agents for, and provided underwriting facilities on behalf of, London-based insurance companies.

The Alliance British and Foreign Fire and Life Insurance Company was reputedly the first company to appoint such an agent. In 1827, just seven years after Stamford Raffles arrived in Singapore, the Alliance appointed the Agency House, Scott and Napier as their agents there⁴⁹. Soon afterwards Guthrie was appointed agents for the Commercial Insurance⁵⁰. In 1846, the Royal Insurance Group appointed Boustead as their agents⁵¹.

Fire policies were the most popular in the early days, mainly due to the fact that most buildings then, including those in the towns, were made of wood and were

48. For an account of the growth and activities of these Houses, see Drabble and Drake, 'The British Agency Houses in Malaysia: Survival in a Changing World', (1981) 12 J. of Southeast Asian Studies, 297.

49. Kohli, RC, An Introduction to Insurance Practice and Principles in Singapore and Malaysia, Singapore Insurance Training Centre, Singapore 1982, pp.9-10.

50. Cheeseeman, HR, 'The Oldest Malayan Firm: The Story of Guthrie & Co. Ltd.' (1955) Vol. V, British Malaya, 37.

51. Kohli, Op. cit., footnote 49.

therefore extremely prone to being destroyed by fire. Later, as Singapore, and to a limited extent, Penang and Malacca, became the focal points of maritime activities in the region, there began a noticeable growth in the area of Marine Insurance. Local marine policies then were issued primarily for cargoes; policies on hull were mainly underwritten in London.

A parallel development took place in Sabah and Sarawak at about the same time. In fact by the end of the 19th century, publications in Sabah were already carrying advertisements inserted by agents who were providing underwriting facilities not only on behalf of London-based companies but also on behalf of those in Hong Kong⁵².

While the Agency Houses were the formal channel for the introduction of the western system of insurance into Malaysia, it is wrong to give them the full credit for this. At about the time when the Agency Houses started to provide underwriting facilities, a group of Indian immigrants were providing insurance and mortgage bond facilities along the lines of Bottomry and Respondentia Bonds in English Marine Insurance. Such policies were commonly known as 'Chitty' Insurance, a name most

52. British North Borneo Herald, 1st January 1892.

probabaly derived from the group of Indian immigrants who introduced such facilities - Chitties or Chettiars being the name of the group of immigrants who came from the Chettinad district of Madras⁵³. Unlike most Indians, they came to Malaysia not as labourers or plantation workers but as businessmen and financiers who dominated the country's moneylending sector in the 19th century and the first half of the 20th century⁵⁴.

A Chitty Insurance came into effect when a Chitty lent a sum of money to the owner of a ship or cargo. The owner would then assign the ship or cargo to the Chitty as security, subject to the standard clause that if the ship or cargo be totally lost by foundering, the borrower was relieved of any further obligation to pay the loan. Loss caused by any other peril must be borne by the borrower, ie. the loan must be paid in full.

The courts in the Straits Settlements recognised and endorsed the validity of Chitty insurance contracts from the beginning. In as early as 1869, in Mootu Curpen

53. A Chitty is also an old Anglo-Indian word for a piece of paper, a note of order or of sum owed, The Concise Oxford Dictionary, 6th Edition 1978.

54. Mahajani, U, The Role of Indian Minorities in Burma and Malaya, Vora and Co., India 1960, and Arasaratnam, S, Indians in Malaysia and Singapore, Oxford University Press, London 1970.

Chitty v Lee Toh⁵⁵, it was held that such contracts were not void as wagers under English Law. In fact in AMK Raman Chitty v Chuah Eu Kay and Ors.⁵⁶, in determining whether a loss was caused by foundering, the court applied English principles relating to proximate cause. In Virappa Chitty v Ventre⁵⁷, it was held that if a foreign vessel was the subject of such an insurance, the seaworthiness of the vessel was to be determined according to the law of the flag.

The close of the 19th century saw not only an increase in the number of Agency Houses providing underwriting facilities for London-based companies but also the setting up of local branches by these companies. The improvement in the facilities provided by these companies and the growth of other sources of credit resulted in a decline in the popularity of Chitty Insurance.

3.3 Developments in the 20th Century

3.3.1 The First Half of the Century

The early part of the 20th century saw two major developments - the influx of branch offices not only for

55. (1869) WOC Appendix III.

56. (1868) SLR 261.

57. Op. cit., footnote 55.

London-based companies but more significantly for companies based in Hong Kong, Canada, India, Australia and the USA, and the birth of locally incorporated insurance companies.

The Sze Hai Tong Bank which was established in Singapore in 1906, was the first local company to provide underwriting facilities. It was not, however, set up for this purpose - it was a commercial bank which provided such facilities as part of the services for its customers⁵⁸. The Great Eastern Life Insurance Company, incorporated in Singapore in 1908, was in fact the first local insurance company⁵⁹. They were followed in 1920 by the Overseas Assurance Corporation which was incorporated in the Straits Settlements with an authorised capital of (M)\$20 million.

The first three decades of the 20th century were a period of tremendous growth for both foreign and local companies. By 1931 there were in West Malaysia and Singapore, 18 life, 46 motor, 81 fire and 50 marine insurance companies providing underwriting facilities⁶⁰.

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58. Lock, LK, 'The Development of Insurance Law in Malaysia', (Unpublished Project Paper) Faculty of Law, University of Malaya, 1980, p.2.
59. (1938) Vol. 13, British Malaya, 93.
60. Eley, WA, 'Insurance', in Singapore - A Handbook of Information, Rotary Club of Singapore, Singapore 1933, pp.70 - 71.

In the area of life insurance alone the volume of business for that year was (M)\$45 million⁶¹.

Throughout this period, the principles and practices of the industry closely followed those in England although certain modifications were made. In the area of life insurance for instance, different scales of premiums were set for Americans and Europeans in one category and for locals and Asiatics generally in another. In fact there was at first a general reluctance to underwrite whole life policies for locals. It was only as late as the 1930s, that some insurers were willing to issue whole life policies, not for locals generally, but on 'selected Chinese lives'⁶². This, coupled with the fact that most locals then viewed insurance as a form of savings for their old age rather than as a means for providing for their dependants, made endowment policies very popular.

The Second World War and the Japanese Occupation caused considerable dislocation to the insurance industry. Recovery was however relatively quick due to the tin and rubber boom which followed.

The industry was again slightly dislocated during the

61. Ibid.

62. Ibid.

period of the Emergency between 1948 and 1960⁶³. The terrorist activities of the outlawed Malayan Communist Party were directed mainly at rubber estates, rubber mills and at vehicles on public roads. Insurance claims increased considerably resulting in increases in premiums for life, fire and civil commotion covers⁶⁴. A racial riot in Singapore in 1950 also resulted in a noticeable increase in claims particularly from owners of vehicles which were either damaged or destroyed⁶⁵.

The ease with which foreign companies could establish themselves locally meant that the industry was still dominated by foreign-based companies, particularly British, even after the first half of the 20th century. In 1955, foreign companies made up about 95% of the local insurance market⁶⁶.

3.3.2 The Period of the 'Malayan Mushrooms'

The post Second World War tin and rubber boom which brought relative prosperity to Malaysians generally, had

63. This was the period during which the country was seriously threatened by Communist insurgents.

64. Mackenzie, KE, Overseas Economic Surveys - Malaya: Economic and Commercial Conditions in Federation of Malaya and Singapore, HMSO, London 1952, p.84.

65. Ibid.

66. Goh, CH, 'Past Present and Future of Insurance Industry', paper presented at the First ASEAN Life Seminar, Kuala Lumpur, 1984.

an adverse effect on the insurance industry. The availability of ready cash in the hands of the public tempted the greedy and the dishonest to find new ways to reach the pockets of the masses. There was a spectacular growth of new insurance companies offering life policies on terms and at premiums no ordinary insurer could have provided⁶⁷. Although the growth of such companies was foreseen by the authorities from as early as 1924⁶⁸ and was generally regarded as an inevitable growing up problem for any country new to the insurance industry, it was not until the late 1950s that the horror caused by these companies was experienced in Malaysia.

These companies dealt exclusively with life policies. They captured the market by introducing policies that were unusually attractive and unorthodox and by targeting people who were either too old or too ill to qualify for genuine life policies. According to one source⁶⁹, the

67. Central Bank of Malaya, Annual Report and Statement of Account 1961, Kuala Lumpur 1962, p.21.

68. In tabling the Life Assurance Companies Bill 1924 before the Federal Council, the Legal Adviser of the Federated Malay States said:

The object... is to prevent the springing up of mushroom companies which receive money from policyholders and carry on for a few years and then collapse.

Proceedings of the Federal Council of the Federated Malay States for the year 1924, FMS Government Printing Office, Kuala Lumpur 1924, pp. B25-B26.

69. Drake, Financial Developments in Malaysia and Singapore, Australian National University Press, Canberra 1969, p.181.

average age of the lives insured with such companies was between 69 and 70 years and there was even a policy issued on the life of a man who was 101 years old.

A typical policy issued by a 'mushroom' company required a registration fee of between (M)\$3 - (M)\$5 and a similar amount in monthly instalments. If the life insured died within nine months after the issue of the policy, his beneficiaries would not get a cent. If he survived this period, his beneficiaries could get anything between (M)\$400 - (M)\$700 on his death. After 10 years the policy would automatically become a fully paid-up policy and only the annual charge needed to be paid thereafter.

As the same flat rates of premiums were charged irrespective of the age and state of health of the life insured⁷⁰, these policies were particularly attractive to those with money and some gambling instincts, especially those with old and sick relatives. Others even resorted to insuring the lives of strangers. The issue of such policies without the usual fuss of the life insured having to fill in detailed proposal forms and to undergo thorough medical check-ups made them doubly attractive to the illiterate and the rural populace. These policies were particularly popular among the Chinese in the tin

70. Ibid.

mining state of Perak. At their peak it was estimated that such companies were receiving about (M)\$100,000.00 monthly in premiums in that state alone⁷¹.

As the policies were mainly taken out on the lives of people who were virtually on their death beds, few survived the initial nine months and so all the premiums paid were lost. The companies were reaping huge profits until the bubble burst in the late 1950s. With about one million such policies issued, the directors of these companies began closing their offices and leaving the country. People with genuine claims could not recover them and those who had paid premiums discovered that their insurance companies were no longer in existence.

It was in the face of this mammoth scandal that the government realised that they could do very little under existing legislation to curb the activities of such companies. As a result, the Life Assurance Act 1961⁷², the Life Assurance (Amendment) Act 1961⁷³ and the Insurance Companies (Compulsory Liquidation) Act 1962⁷⁴ were speedily introduced to make it more difficult to start life insurance businesses, to tighten controls over

71. Dale, M, ' 'Mushroom' Insurance Firms', Far Eastern Economic Review, 27th April 1961, p. 175.
72. FM Act No. 48 of 1961.
73. FM Act No. 20 of 1961.
74. FM Act No. 1 of 1962.

existing ones and to enable the government to wind-up existing 'mushroom' companies. By the end of 1962, 39 such companies were wound up with claims made in respect of 1.3 million policies⁷⁵.

The facts surrounding the compulsory liquidation of Poh Sin Insurance Co. of Penang, the 38th company to be liquidated under the 1962 Act clearly reflected the extent of the scandal. Starting with a capital of (M)\$400,000, it had been carrying on business for just 17 months when it was compulsorily liquidated. Yet it was insolvent to the tune of (M)\$8.5 million and had collected more than (M)\$3 million in premiums⁷⁶.

Undeniably the period of the 'Malayan Mushrooms' was an inglorious event in the history of the insurance industry in Malaysia although some good did come out from it. It generated new and widespread public interest in the insurance industry as a whole. More people became aware of the idea of insurance and the benefits that could be obtained by insuring with genuine and reputable insurers - either because they had lost their money to the 'mushroom' companies or because they were interested

75. Central Bank of Malaya, Annual Report and Statement of Account 1962, Kuala Lumpur 1963, p.38.
76. 'The Malayan Mushrooms', Far Eastern Economic Review, 9th August 1962, p.268.

bystanders during the scandal. The aftermath of the scandal also saw the introduction of a comprehensive piece of insurance legislation in the form of the Insurance Act 1963, which not only introduced extensive regulatory measures but also certain changes to the substantive law.

3.3.3 Post 1963 Developments

By the time the Insurance Act 1963 was passed, most of the problems caused by the mushroom companies had been ironed out. The years after 1963 saw the efforts of the government being concentrated primarily on domestication or Malaysianisation of the industry. In establishing and projecting a Malaysian profile for the industry, local capital ownership was stimulated, steps were taken to facilitate the transfer of managerial expertise to locals and requirements were introduced to ensure the retention of a percentage of the insurance funds within the country. The setting up of new local companies was encouraged and branches of foreign-based ones were persuaded to be domestically incorporated, some were simply deregistered while others voluntarily ceased to carry out underwriting business⁷⁷.

77. Lloyd's of London ceased to underwrite general insurance in the country in 1984 - Information Malaysia - 1985 Yearbook, Berita Publishing, Kuala Lumpur 1985, pp.226-228.

In line with the government's New Economic Policy⁷⁸, the participation of locals, particularly the Malays who were more economically backward, at the executive and technical levels were actively encouraged. To this end the Insurance Training Centre was set up and the MARA Institute of Technology introduced diploma courses in Insurance. Insurance companies were also expected to play a wider role by facilitating and participating in, the implementation of the government's socio-economic policies.

Motivated by the realisation of the importance of insurance companies as a non-banking source of both public and private sector finances and the desire to reduce the country's invisible trade deficit, conscious efforts were made to ensure the retention of at least a percentage of the insurance funds for investments within the country. Since 1963, the government has consistently increased the percentage of premium incomes which must be invested locally, a fraction of which must be in government stocks⁷⁹.

78. A government development strategy which has as its objectives the restructuring of society and the eradication of poverty.

79. At present no less than 80% of the total value of an insurer's assets must be Malaysian assets and investments in government securities must form no less than 25% of the insurer's entire assets - Insurance Act 1963, s.11.

In spite of these efforts there were still until 1972, huge outflows of insurance funds overseas mainly in the form of premiums for reinsurance as there were then no local reinsurance facilities. In 1973 the government set up the country's national reinsurance company, the Malaysia National Reinsurance Berhad.

Since 1963, the Insurance Act has undergone numerous amendments including a revision in 1972, which were intended mainly to tighten control not merely on insurance companies but also on their directors, agents, brokers and adjusters, in an effort to give the insuring public greater protection. Self - regulation within the industry was also encouraged by introducing mandatory requirements for membership of approved associations for the insurers and their intermediaries.

The introduction of an Islamic system of mutual insurance by the Takaful Act 1984, did not affect the existing industry although it is a landmark in the development of the insurance industry in the country in that for the first time consumers have a choice of two different systems of insurance to choose from.

4.0 Insurance Legislation in Malaysia

4.1 Legislation Affecting Life Insurance Companies

The earliest piece of legislation in this respect was the

Life Assurance Ordinance 1941 of the Straits Settlements⁸⁰. It was modelled on the Assurance Companies Act 1909 of the United Kingdom but was restricted in its application to companies carrying life insurance business. Similar legislation were subsequently introduced in the Federated Malay States⁸¹ and Johore⁸².

In 1948, the existing legislation was replaced by a consolidated statute applicable throughout the Federation of Malaya - The Life Assurance Companies Ordinance 1948⁸³. The period of the 'Malayan Mushrooms' necessitated stricter controls over life insurance companies and amendments to the 1948 Ordinance were introduced by the Life Assurance Act 1961 and the Life Assurance Companies (Amendment) Act 1961. New powers for compulsory liquidation were given by the Insurance Companies (Compulsory Liquidation) Act 1962⁸⁴.

In Sabah, provisions relating to life insurance companies were first introduced by the Life Assurance Companies Ordinance 1950⁸⁵. Sarawak had no specific legislation in this area but its Companies Ordinance 1956 had special provisions dealing with insurance companies⁸⁶.

80. SS Ordinance No. 145.

81. Life Assurance Companies Enactment 1924 (Cap. 60).

82. Johore Enactment No. 129.

83. FMS Ordinance No. 38 of 1948.

84. Supra. p.30.

85. Sabah Ordinance No. 20 of 1950 (Cap. 7).

86. Cap.65, Laws of Sarawak 1958, s.130.

4.2 Legislation Affecting Fire Insurance Companies

The Straits Settlements again led the rest of Malaysia in this respect by the introduction of the Fire Insurance Companies Ordinance 1917⁸⁷. This too followed the Assurance Companies Act 1909 of the United Kingdom. The Federated Malay States and Johore followed soon afterwards by the introduction of similar legislation⁸⁸. All these statutes were replaced by the Fire Insurance Companies Ordinance 1948 of the Federation of Malaya⁸⁹. Sabah introduced its Fire Insurance Companies Ordinance in 1950⁹⁰. As in the area of life insurance, Sarawak had no specific legislation in this respect.

4.3 Legislation Introducing Compulsory Insurance

Compulsory Third Party Motor Insurance was introduced in the Federated Malay States in 1937 by the Road Traffic (Third Party Insurance) Enactment 1937⁹¹ which was based on similar provisions in the Road Traffic Act 1930 of England. This was perhaps prompted by the decision in King Lee Tee v Norwich Union Insurance Co.⁹² whereby it

87. SS Ordinance No. 164 of 1917.

88. FMS Ordinance No. 3 of 1918 (Cap. 59) and Johore Enactment No. 130.

89. FM Ordinance No. 39 of 1948.

90. Sabah Ordinance No. 19 of 1950, replaced by Fire Insurance Companies Ordinance Cap. 46.

91. FMS Enactment No.17 of 1937.

92. Op. cit. footnote 40.

was held that the 1930 Act of England including the provisions relating to compulsory insurance therein, was inapplicable in the Straits Settlements under s.5(1) of the Civil Law Ordinance of 1909 as the 1930 Act did not come within the scope of that provision.

Similar legislation was subsequently introduced in the Straits Settlements⁹³, Johore⁹⁴, Kedah⁹⁵ and Trengganu⁹⁶. The 1938 Straits Settlements Ordinance was replaced by the more comprehensive Road Traffic Ordinance 1941⁹⁷ which included provisions relating to compulsory third party insurance in Part II. All were subsequently repealed and replaced by the Road Traffic Ordinance 1958 of the Federation of Malaya⁹⁸.

In Sabah, compulsory third party motor insurance was introduced by the Road Traffic (Third Party Insurance) Ordinance 1950⁹⁹. In Sarawak, similar provisions were found in the Motor Vehicles (Third Party Insurance)

93. SS Ordinance No.5 of 1938.

94. Road Traffic (Third Party Insurance) Enactment 1938.

95. Road Traffic Enactment No. 16 of 1356 (1938 AD).

96. Motor Vehicle Enactment No. 16 of 1356 (1938 AD).

* 98. FMS Ordinance No. 49 of 1958.

99. Sabah Ordinance No. 27 of 1950, later replaced by Road Traffic (Third Party Insurance) Ordinance (Cap. 129, Revised Laws of North Borneo).

* 97. SS Ordinance No.17 of 1941. 37

Ordinance 1949¹. In 1984, the Road Traffic Ordinance 1958, of the Federation of Malaya was extended to Sabah and Sarawak, and the existing state Ordinances were repealed².

Another form of compulsory insurance was introduced during the Second World War - Compulsory War Risks Insurance On Goods. In an attempt to give the trading community some measure of financial protection against the effects of war, a risk which was not then ordinarily insurable with commercial insurers, the governments of both the Straits Settlements and the Federated Malay States introduced a scheme of compulsory insurance for certain goods³ against war risks under the War Risks (Goods) Insurance Ordinance⁴ and War Risks (Goods) Insurance Enactment⁵ respectively. A War Risks Insurance Fund which provided insurance by policy for most commodities and insurance by way of fee collection for tin and tin ore, was set up by both governments. After the war, the Board of Management of the Fund was temporarily reconstituted as a claims settling body.

1. Laws of Sarawak Cap. 130.
2. Malaysia Act 1963, s.74 and Modification of Laws (Road Traffic Ordinance) (Extension and Modification) Order 1984, PU(A) 136/84.
3. As to the definition of 'Goods', see: Straits Echo Press Ltd. v Board of Management of War Risks (Goods) Insurance Fund (1941) 10 MLJ 211.
4. SS Ordinance No. 19 of 1941.
5. FMS Enactment No. 6 of 1941.

4.4 Workmen's Compensation Legislation

In the area of Workmen's Compensation, there used to be three pieces of legislation applicable in different parts of the country. In the Federation of Malaya it was the Workmen's Compensation Ordinance 1952⁶ while Sabah and Sarawak had their own Ordinances⁷. The Federation of Malaya Ordinance was subsequently extended to the two states in 1981⁸. Employers are required by the Ordinance to insure their potential liability to employees⁹. The significance of this Ordinance and the reliance of employers on Employer's Liability Insurance however have been greatly reduced since the introduction of a scheme of social insurance for employment injury and invalidity benefits under the Employees' Social Security Act 1969¹⁰ as participants in this scheme are not entitled to benefits under the Workmen's Compensation Ordinance. As the new scheme is financed wholly by contributions from employers and employees, commercial insurers do not have a role to play.

4.5 The Insurance Act 1963

This Act is the main piece of insurance legislation in

6. FM Ordinance No. 85 of 1962.

7. Sabah Ordinance No. 14 of 1955 and Cap. 80, Laws of Sarawak.

8. Modification of Laws (Workmen's Compensation) (Extension and Modification) Order 1981.

9. s.26.

10. Laws of Malaysia, Act 4.

Malaysia at present. It repealed all the existing insurance legislation in the Federation of Malaya except the Insurance Companies (Compulsory Liquidation) Act 1962. When first introduced, the Insurance Act was applicable throughout the whole of the Federation including Singapore. After Singapore left Malaysia in 1965, it introduced its own Insurance Act and the 1963 Act ceased to be applicable there¹¹. The 1963 Act was extended to Sabah and Sarawak in 1965¹²

Numerous amendments have been made to the Act since 1963. It remains still the main source of insurance regulation in the country and, albeit in a very limited sense, the only local Act with some provisions relating to the substantive aspects of Insurance Law.

11. Insurance Act 1965 (Singapore), s.267.
12. Malaysia Act 1963, s.74 and Legal Notification LN470/64.

CHAPTER TWO

CONTRACTUAL FORMALITIES

1.0 Essentials of a Valid Contract Generally

In Malaysia all contracts are subject to the provisions of the Contracts Act 1950¹. The Specific Relief Act 1950², too, has provisions applicable to contracts such as those relating to specific performance³, rescission⁴ and rectification⁵. Other written laws as well as usages or customs of trade which are not inconsistent with the Contracts Act may also be applicable⁶.

Under the Contracts Act, what is termed an 'offer' in English law is known as a proposal. A proposal made by one party to another triggers the mechanism for the formation of a contract. A proposal is made when one party signifies to another his willingness to do or abstain from doing anything, with a view to obtaining the consent of that other party, to the act or abstinence⁷. The proposal must be communicated to the other party and

1. Revised 1974, Laws of Malaysia, Act 136.
2. Revised 1974, Laws of Malaysia, Act 137.
3. s.11 - s.27.
4. s.30 - s.33.
5. s.34 - s.37.
6. Contracts Act 1950, s.1(2).
7. s.2(a).

such communication is complete when the proposal comes to the knowledge of the other party⁸. If the proposal is accepted, such acceptance must be communicated to the proposer⁹.

The communication of an acceptance is complete as against the proposer when it is put in a course of transmission to him so as to be out of the power of the acceptor¹⁰. If an acceptance is conveyed by post, it binds the proposer from the time the letter of acceptance is posted, even if the letter fails to reach him. The acceptance only binds the acceptor when the letter in fact reaches the proposer¹¹. Similar rules apply to the revocation of either a proposal or an acceptance¹².

When the letter of acceptance is in the post there exists, technically, an impossible situation where the contract binds only one of the contracting parties. This has not resulted in any particular problems in relation to contracts of insurance because such contracts stipulate the date and time when the provision of cover under the policy commences. Should such a problem arises, the solution provided in the case of Ignatius v Bell¹³

8. s.4(1).

9. s.4.

10. s.4(2)(a).

11. s.4(2)(b).

12. s.4(3)(a) and (b).

13. (1913) 2 FMSLR 115.

ought to be followed. It was held in that case that if the parties contemplated the use of the post as a means of communicating the acceptance, then there would be a valid contract from the time the letter of acceptance was posted, even if the letter did not reach the proposer at all.

A contract to be valid must be made by the free consent of the parties and for a lawful consideration and must not be expressed to be void under the Contracts Act¹⁴.

An intention to create legal relations is not expressly required under the Act as a pre-requisite for a valid contract. It is however generally assumed that such a requirement must be implied in all contracts¹⁵.

There is no requirement under the Contracts Act that a contract must be in writing. The Act however recognises that this may be required in relation to particular contracts by related statutes¹⁶. Although the Insurance Act has provisions relating to the the type of forms, policies and brochures used by insurers, there is no specific requirement that a contract of insurance must

14. s.10(1).

15. Sinnadurai, V, The Law of Contract in Malaysia and Singapore; Cases and Commentary, Oxford University Press, Kuala Lumpur 1979, pp.28-29.

16. Contracts Act 1950, s.5(1).

be in writing. The definition of the word 'policy' as given in the Act in fact seems to imply that there can be an unwritten contract of insurance¹⁷.

2.0 Formation of a Contract of Insurance

2.1 Proposal and Acceptance

In a contract of insurance, the proposal is commonly, though not necessarily, made by the insured when he fills in the proposal form and the proposal is communicated when it is submitted to the insurer. If, having submitted the proposal form the insured decides to withdraw it, he can do so before the insurer communicates their acceptance. Once accepted by the insurer, the proposal cannot generally be revoked¹⁸.

The insurer's response to the proposal can be either an acceptance or a counter-proposal. It is an acceptance if the insured's proposal is unequivocally accepted and no new terms are introduced. An acceptance must be expressed either in the form prescribed in the proposal or in a usual and reasonable manner, and must be made within a

17. 'Policy' includes any contract of insurance whether or not embodied in or evidenced by an instrument in the form of a policy; Insurance Act 1963, 1st Schedule.

18. Contracts Act, s.5(1).

reasonable time after the receipt of the proposal¹⁹.

If the insurer's response to the proposal includes the introduction of new terms and conditions, it is a counter-proposal which can be either accepted or rejected.

Unless the proposal form stipulates to the contrary, an insured in making a proposal for insurance is presumed to be asking for the insurer's usual policy. This is so even if the particular insurer's policy contains terms which are not common amongst insurers generally. In Pang Lim v China Insurance Co. Ltd.²⁰, the appellant had a comprehensive motor policy issued by the respondent. The cover note stated that he was held covered 'in the terms of the company's usual form of Comprehensive Policy'. The policy which was subsequently issued to the appellant had deleted a clause which provided cover whilst he was driving another car. He sought a declaration that the deletion was null and void and rectification of the policy. According to the evidence the deletion of such a clause though not illegal, was in breach of the Code of Ethics of the Malaysian Insurance Association (MIA) of which the respondent was a member. It was held that the

19. s.7(a) and (b).

20. [1975] 1 MLJ 239.

policy was valid and the appellant was not entitled to the declaration sought, because he had asked for and obtained the insurer's usual policy. According to Chang Min Tat J:²¹

The basic difficulty encountered by the appellant was that in a contract with his insurers, it was the insurer's usual form of policy that he asked for and was given, not the common policy of the MIA, and that he could not dispute that the insurer's usual policy as used at the relevant time was with the sub-clause deleted.

2.2 Consideration

Like other contracts, a contract of insurance must be for lawful consideration²². To be lawful, consideration must not be forbidden by law, or be intended to defeat any law, or be fraudulent, or involve or imply injury to others, or be immoral or opposed to public policy²³.

In a contract of insurance, the insurer promises to pay either to the insured or to a third party, policy moneys on the occurrence of the insured event. The consideration provided by the insured is the premium which he pays to the insurer, either in lump sum at the beginning of the contract, or periodically in the case of long-term

21. Ibid. at p.240.

22. Contracts Act 1950, s.2(d).

23. s.24.

policies. If the premium payable at the commencement of the contract is not paid, the contract will be void for want of consideration. If the premium for a long-term policy is not paid when it falls due the contract too lapses for want of consideration²⁴. A life policy which has been in force for three years or more however will not lapse for the non-payment of premium²⁵.

2.3 Parties to the Contract and their Capacity

To be competent to contract, a person must be of the age of majority, of sound mind, and not disqualified from contracting by any law to which he is subject²⁶.

A person attains the age of majority on his eighteenth birthday²⁷. The Insurance Act however allows a person below that age to enter into a contract of insurance. S. 41(1) reads:

Notwithstanding any law to the contrary, a person over the age of ten years shall not by reason of being only under the age of majority lack the capacity to enter into a contract of insurance; but a person under the age of sixteen years shall not have the capacity to enter into such a contract except with the consent in writing of his parent or guardian.

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24. Lai Ah Heng & Anor. v China Underwriters Ltd.
(1948-49) MLJ (Supp.) 85.
25. Insurance Act 1963, s.43(2). See Chapter Six -
Premiums.
26. Contracts Act 1950, s.11.
27. Age of Majority Act 1971, s.2.

One who is above sixteen years of age therefore has the full capacity to enter into a contract of insurance while one who is between ten to sixteen years of age has such capacity if supported by written consent from his parent or guardian.

The rationale behind s.41(1) is unclear. It allows minors to enter into contracts of insurance, but does not allow them to enter into other contracts which, though not in themselves contracts of insurance, may involve or relate to such contracts. It does not allow, for instance, a minor to enter into a contract of assignment of a policy either as an assignor or assignee. Nor does it allow a minor to enter into a contract to mortgage the policy or to use it as a security for a loan. As these are not 'contracts of insurance' they are not within the purview of s.41(1).

The Life Insurance Act 1945 of Australia has a provision allowing minors to enter into a contract of life insurance²⁸. This provision however goes a step further than the Malaysian provision. It provides that a minor between ten and sixteen years old can also be assigned a policy of insurance with the written consent of his parent or guardian. One who is above sixteen years old

28. s.85(1).

not only can be assigned a policy with the written consent of his parent but he can also exercise all the powers and privileges of a policyholder as if he has attained the age of majority²⁹.

Apart from being restricted only to life insurance, the Australian provision clearly provides minors with a greater degree of freedom in dealing with their policies. The Malaysian provision only allows a minor to enter into a contract of insurance; to do anything else with his policy he has to wait until he attains the age of majority.

S.41(1) as it stands seems to be of little, if any, practical utility. If the rationale behind this provision is to allow minors to protect their interests, this can be done by the use of other existing provisions and legal principles. In the area of life insurance, a parent who wishes to provide security for his child through the instrumentality of an insurance policy can do so by naming such child as a beneficiary to his (the parent's) own life policy, thereby creating a trust in favour of the minor³⁰. A parent or guardian can also take out a policy on the life of the minor because under the

29. s.85(2) and (3).

30. See Chapter Twelve - Assignment and Trusts.

Insurance Act, a parent or guardian has an insurable interest in the life of a child or ward who is below the age of majority at the time the insurance is effected³¹. By using either of these two ways, the interest of the minor is protected without sacrificing any of the rights and privileges of a policyholder.

The only interest a minor can have in immoveable property is as a beneficiary under a trust³². In such a situation his interest can be protected by the trustees themselves insuring the trust property. There is no necessity for the minor himself to enter into a contract of insurance to protect his beneficial interest in the property.

S.41(1) does not therefore provide any wider protection for the interest of the minor than that already provided by other existing provisions and principles in Insurance Law. Rather s.41(1) can be a dangerous trap for unwary minors and their parents or guardians. It allows a minor to enter into a contract of insurance but not thereafter to deal with it in any way until the minor reaches the age of majority.

31. Insurance Act 1963, s.40(2).

32. No alienation of, nor any other dealings in such property can be made in favour of a minor - National Land Code 1965, s.43 and s.205(2).

Apart from individuals, other legal entities such as firms, companies and corporations too have the capacity to enter into a contract of insurance. Such power is usually provided by the laws under which such entities are set up, be it the Partnership Act 1967, the Companies Act 1965 or the Act of Parliament which sets up the particular corporation.

If such an entity enters into a contract of insurance as the insured, the contract is entered into by its partners or directors for and on its behalf. The insured is not the person who signs the contract but the person or persons for whom the entity intends to provide the insurance protection.

In Poh Sin Mining Co. v Welfare Insurance Co. Ltd.³³, the plaintiff company made a claim under a workmen's compensation policy issued by the defendant. The defendant denied liability on the ground that the policy was not issued to the plaintiff company but to two individuals, Lau and Hah. In the proposal form it was stated that the policy was to be in the names of these two persons but it was also stated that the workmen to be covered by the policy were in the employment of the plaintiff company. The cover note was issued in the names

33. [1971] 1 MLJ 65.

of Lau and Hah. It was held that the insured under the policy were the plaintiff's workmen and therefore the insurer was liable.

The requirement of insurable interest in contracts of insurance also means that a person without such interest has no capacity to enter into a contract of insurance³⁴.

In the case of the insurer, its capacity to enter into a contract of insurance depends on whether it is authorised to carry out such insurance business³⁵. An insurer who is not registered with the Director-General of Insurance cannot carry out insurance business and hence lacks the capacity to enter into such contracts³⁶.

2.4 Consent/Consensus Ad Idem

To be valid, a contract must be entered into with the free consent of the parties³⁷. Consent is free if it is free from coercion, undue influence, fraud, misrepresentation or mistake³⁸. Except where 'high pressure' methods are used by intermediaries, it can be

34. See Chapter Three - Insurable Interest.

35. Insurance Act 1963, s.3(2)(a).

36. As to the effect of contracts with such insurers, see infra. pp.74 - 75. See also Chapter Fourteen - Statutory Regulation of the Insurance Industry.

37. Contracts Act 1950, s.10(1).

38. s.14.

generally presumed that an insured enters into a contract of insurance with free consent. The insured is deemed to consent to all the terms and conditions in the insurer's usual policy. This is so even if the insured does not get precisely what he bargained for³⁹.

The Contracts Act does not mention consensus ad idem as a separate element for the validity of a contract. A meeting of the minds is in fact a necessary constituent of the element of free consent which is defined as the agreement between two or more persons upon the same thing and in the same sense⁴⁰.

In insurance, it is the element of consensus ad idem rather than that of consent that is frequently emphasised by the courts. The former has not however been given a meaning which is substantially different from or wider than, the latter.

If there is consensus ad idem between the contracting parties but the policy fails to reflect this, either party can seek a rectification of the policy. Such an action will not succeed if the parties have never been ad idem at any time. In Tay Hean Seng v China Insurance Co. Ltd.⁴¹, the insurer claimed that a motor policy issued by

39. Pang Lim v China Insurance Ltd., Op. cit. footnote 20.

40. s.13.

41. (1953) 19 MLJ 38.

them did not cover liability to a pillion rider. The appellant contended that such liability was covered by the policy or if it was not so covered, that he was entitled to a rectification of the policy to include such liability. Brown J refused to allow the policy to be rectified because:⁴²

[R]ectification can only be granted where the document fails to represent the common intention of the parties, and in order to make it conform to what they have agreed...there was never agreement between the parties that death or injuries sustained by a pillion rider should be covered...the parties were at no time ad idem on this matter.

If a contract of insurance is tainted with illegality and one of the parties is unaware of this, there can be no consensus ad idem between the parties⁴³. Parole evidence is admissible to show that parties to a contract were ad idem on a particular matter⁴⁴.

3.0 Cover Notes

A cover note is a document issued by the insurer prior to the issue of a policy. It provides evidence of the existence of insurance cover for a temporary period. A cover note serves the dual purpose of providing the

42. Ibid. at p. 41.

43. Asia Insurance Co. Ltd. v American International Assurance Co. Ltd. (1953) 19 MLJ 87. See infra. p.73.

44. Ibid. at p.88.

insured with immediate cover whilst giving the insurer the opportunity to consider and make a final decision on whether or not to issue a policy and thereafter, if necessary, to prepare the said policy.

Being as its name suggests, merely a note, a cover note contains only the minimum of details about the cover provided. It does not exhaustively define the scope of the cover nor does it stipulate all the terms and conditions which are applicable thereto. The terms and conditions in the insurer's usual policy are often made applicable to the holder of a cover note by means of a clause which incorporates such terms and conditions into the cover note. The effect of an incorporation clause is to make all the terms and conditions in the insurer's usual policy applicable to the holder of the cover note. This is so even if he has no knowledge of those terms and conditions.

In Chop Eng Thye Co. v Malaysia National Insurance Bhd.⁴⁵, in March 1971 the plaintiff applied to the defendant for a fire policy for their smoke-house and its contents, for a period of one year from 2nd April 1971. Pursuant to this, a cover note was issued. Four days later the smoke-house and its contents were destroyed by

45. [1977] 1 MLJ 161.

fire. As the defendants failed to settle the claim, the plaintiffs filed an action against them on 16 May 1972. In denying liability, the defendant relied on a condition which stipulated that they would not be liable for any loss or damage after the expiration of twelve months from the happening of the loss unless the claim was the subject of a pending action or arbitration⁴⁶. This condition was not in the cover note itself but was in the insurer's usual fire policy. The defendants contended that the condition was applicable by virtue of an incorporation clause in the cover note. Citing the English cases of Queen Insurance Co. v William Parsons⁴⁷ and General Accident, Fire and Life Assurance Corporation Ltd. v Shuttleworth⁴⁸, Ajaib Singh J accepted the defendant's contention. According to the learned judge:⁴⁹

[B]y incorporating the clauses and conditions of the defendant's fire insurance policy in the cover note in that form and content both plaintiffs and the defendants rendered themselves bound by those clauses and conditions.

According to the Privy Council in Queen Insurance Co. v William Parsons, there was no duty on the insurer to show that the incorporation clause in the cover note had been

46. As to the legality of this and similar clauses, see infra. pp.69 - 73.
47. (1881-82) 7 App. Cas. 96.
48. (1938) 60 Ll. LR 30.
49. Op. cit. footnote 45 at p.165.

brought to the notice of the insured or that he had in fact had the opportunity of knowing what those terms and conditions were. Implicit in the decision in Chop Eng Thye is the recognition of the validity of such a ruling in Malaysia.

Given the special circumstances characterising the Malaysian insurance market which put the insured in a particularly vulnerable position, such as the use of English in policies, the lack of professionalism among intermediaries coupled with a heavy reliance upon them by the insuring public and the low level of consumer awareness about insurance transactions generally, the application of such a ruling in Malaysia seems unduly harsh.

While there is no necessity to prohibit the use of incorporation clauses altogether, measures can be taken to regulate their use. The insurer should be statutorily compelled to issue with every cover note, a specimen copy of their usual policy for the particular type of insurance for which the cover note is issued. This will provide the holder of a cover note with the opportunity of finding out the terms and conditions to which his cover is subject. Compliance with such a requirement can be ensured by introducing a provision which makes an incorporation clause in a cover note ineffective unless the cover note is issued together with a specimen copy of the policy.

Normally the duration of the validity of the cover note is stated in the note itself. In such a case unless extended, the cover note expires on the date stated. If a policy is issued prior to that date, the cover note ceases to be valid from the date the policy is issued. Once a cover note ceases to be valid, it no longer forms part of the contractual documents between the insurer and the insured and cannot therefore be used for the purpose of construing a policy⁵⁰.

4.0 Commencement and Termination of a Contract of Insurance

4.1 Commencement

In a contract of insurance, the commencement of a contract and the commencement of the cover provided by the policy need not necessarily coincide although the latter cannot commence before the former.

A contract is complete when the proposal is accepted by the person to whom it is made and such acceptance is communicated to the proposer⁵¹. Generally commencement of the risk or the cover provided by a policy of insurance can be at any time after the formation of the contract.

50. Poh Sin Mining Co. v Welfare Insurance Co., Op. cit.
footnote 33.

51. Contracts Act 1950, s.7.

In non-life insurance however, the Insurance Act makes the payment of a premium, or a deposit or at least a guarantee that the premium will be paid within the stipulated time, mandatory before the risk under the policy can commence⁵². Although there is no parallel provision for life insurance, the commencement of cover thereunder is normally postponed until a stipulated date or until a certain condition is satisfied, such as the payment of the first premium by the insured or the issue of policy by the insurer or both.

Whilst the date on which the cover provided by a policy commences is vital for determining when the policy is in fact operative, the date on which the contract commences or is formed is equally important as it is from that date that the parties are bound by the contract. It is also from that date that the duty of disclosure ceases.

There can, however, be times when the distinction between the formation of the contract and the commencement^e of cover under the policy is blurred. In Borhanuddin bin Haji Jantara & Ors. v American International Assurance Co. Ltd.⁵³, Azian an air stewardess was killed when the plane in which she was on duty crashed on 4 December

52. Insurance Act 1963, s.14A.

53. [1986] 1 MLJ 246 (High Court) and [1987] 1 MLJ 22 (Supreme Court).

1977. Just prior to that, Azian had completed a proposal form for an insurance policy on her life, with the respondent. The proposal was dated 21 November 1977 and in it she proposed to insure her life for (M)\$50,000 to mature on her death or on her reaching the age of 55 years, whichever is sooner. She also asked for an additional cover of (M)\$50,000 for death by accident. The premium was proposed to be paid on a monthly basis. At the bottom of the proposal form was a declaration signed by Azian that 'the assurance herein applied for shall not take effect unless and until a policy is issued and delivered ' and 'the first premium thereon actually paid in full' during her lifetime and in her good health and that 'if the premium be paid in cash at the time of signing the application and a conditional receipt issued thereto, the provisions of the receipt shall apply'.

Azian's proposal form reached the respondent's underwriting department on 5 December 1977. There was evidence that Azian had, on a different occasion before the crash, paid (M)\$118 to the respondent's cashier for which a receipt had been issued. It was not indicated what the payment was for. At the back of the receipt, under 'Conditions of Payment' it was stated that the receipt of the money in no way committed the respondent to the acceptance of the proposal and that the respondent was entitled to return the money to the payer.

Action was brought by the administrators of Azian's estate alleging that she had a valid policy on the day of the fatal crash. The respondent contended that there was no concluded contract because the issue of a policy was a condition precedent for the commencement of cover and Azian had not been issued with a policy. The plaintiffs argued that there was a concluded contract from the time the respondent received the (M)\$118 and that the notice at the back of the receipt was not binding.

The High Court dismissed the action on the grounds that there was no concluded contract because no policy had been issued and because the exact amount of the premium payable was never determined.

On appeal, the Supreme Court reversed the decision of the High Court for two reasons. First they accepted the evidence of the respondent's life underwriter that the payment made by Azian was in fact the first premium. Second, they held that the condition at the back of the receipt was inapplicable because the proposal form stated that such condition was applicable only if payment was made at the time the proposal form was signed. Azian made her payment on a different occasion, after she had signed and submitted the proposal form.

According to the Supreme Court there was a contract in existence and as Azian, by paying the premium, had

performed her part of the bargain, it was the insurer's duty to issue and deliver the policy to her, otherwise they would be in breach of contract.

The decision of the High Court which was based on the non-existence of a contract rather than the non-commencement of the cover leans more favourably towards the insurer. It unnecessarily lengthens the period of disclosure and allows the insurer to take into account an increase in risk even at the stage where the provision of cover has been agreed to, simply because either the policy has not been issued or the premium has not been paid or both. The decision of the Supreme Court that there was a valid policy and that the risk had commenced from the moment the insured performed her part of the bargain, is therefore a welcome development. A logical consequence of this decision is that the duty of disclosure also ceases once the insured has performed her part of the bargain.

The Supreme Court decision seems to be consistent with English decisions like Canning v Farquhar⁵⁴ where it was said that once the premium was accepted, there existed a valid contract, as the insurer had the right to refuse the risk only before the premium was accepted. A similar

54. (1886) 16 QBD 727 at pp.731 - 732, per Lord Esher MR.

view was expressed in relation to a contract for the renewal of cover in Solvency Mutual Guarantee Co. v Froane⁵⁵.

Neither the payment of the premium nor the issue of a policy is a pre-requisite for the formation of a contract. Where the provision of cover before payment of premium is prohibited or where the insurer agrees to provide cover subject to the fulfillment of these conditions, there exists a valid contract. However, the provision of cover thereunder is postponed until such conditions are satisfied. By drawing a distinction between the two, the interest of the insured can be safeguarded, as an insurer who thereafter refuses to accept the premium tendered or to issue a policy will be in breach of contract. The duty of disclosure also ceases from the time the contract is formed, not from the time the provision of cover commences.

4.2 Termination

A contract of insurance for a specific period comes to a natural end once that period has expired. In a long term insurance contract, where the premium is payable periodically, while the contract is generally regarded

55. 158 ER 369 at p.373, per Bramwell B.

as being for the entire term, its continuance is subject to the periodic payment of the premiums. If the premium is not paid when it is due or after the expiration of the days of grace, if any, the contract ceases for failure of consideration; the periodic payment being part of the consideration for the contract. A life policy which has been in force for three years or more however will not lapse for non-payment of the premium⁵⁶. It shall instead remain valid subject to modification by the insurer as to the period for which it is to remain in force or as to the amount of benefits payable thereunder or both.

An insured who has had a life policy or a home service policy for a period of three or six years respectively can also voluntarily terminate the contract by surrendering the policy for its surrender value or exchanging it for a fully paid-up policy⁵⁷.

A contract of insurance can also be cancelled by the insurer if the insured has breached a condition in the policy⁵⁸. If such cancellation is communicated by post to the insured, it is effective from the date the notice of cancellation is posted. This is so even if the notice failed to reach the insured. In Lee Seng Heng & Ors. v

56. Insurance Act 1963, s.43(2).

57. s.43(1) and (2).

58. Lee Cheng Oo v China Insurance Co. Ltd. (1962) 28 MLJ 297.

Guardian Assurance Co. Ltd.⁵⁹, the plaintiff insured their stock-in-trade and furniture under the defendant's fire policy for a period of one year from 6 February 1931. The policy was effected and the premium was paid through an agent in Malacca as the defendant's head office was in Singapore. A fire destroyed the plaintiff's entire premises.

The defendant denied liability claiming that they had effectively cancelled the policy prior to the fire and that such cancellation had been communicated to the plaintiff by means of a letter sent through the post. The letter was delayed in the post and by the time it was to be delivered, the plaintiff's premises had been burnt down so it was returned to the defendant. It was held that the cancellation was effective from the date the letter was posted and so the defendant was not liable under the policy.

The validity of this decision in Malaysia today is suspect. It was decided in Singapore and the law applicable there was the English Law. The Contracts Enactment 1899 of the Federated Malay States which preceded the Contracts Act 1950, was not applicable there. Although the present Contracts Act does not have a provision relating to the communication of a notice of

59. (1932) 1 MLJ 17.

cancellation of a contract, it has provisions relating to the revocation of an acceptance. Such communication is complete as against the person to whom it is addressed only when it comes to his knowledge⁶⁰. Thus the risk of delay or non-delivery when the revocation is communicated by post is borne by the sender. If the cancellation of an existing contract can be equated with the revocation of an acceptance, the above provision should at least be used as a guiding principle in determining when a notice of cancellation which is sent by post is effective.

In a contract of insurance on goods, the insured must have an insurable interest in the goods both at the inception of the policy as well as at the time of loss. Such a contract of insurance therefore lapses if the insured ceases to have an insurable interest in the subject matter of the insurance. In Roslan bin Abdullah v New Zealand Insurance Co.⁶¹, the appellant was injured in a collision between a lorry driven by him and another driven by one Lee and belonging to the United Malaya Co. and allegedly insured with the respondent. Having obtained but failed to enforce judgements against both Lee and the United Malaya Co., the appellant sought to recover the damages from the respondent as insurers of the lorry. The respondent denied liability on the ground

60. Contracts Act 1950, s.4(2)(a).

61. [1981] 2 MLJ 324.

that they were insurers of the said lorry when it belonged to its previous owner, Messrs. Wee & Wee. As the lorry had been sold by them to the United Malaya Co., the policy had lapsed. Both the High Court and the Federal Court upheld the respondent's contention.

While an insured under a long-term policy in England has a statutory right of cancellation within a stipulated time without having to give any reason⁶², the Malaysian insured is in a less envious position. The Insurance Act gives the insured under a life policy (including a home service policy), the right to cancel the policy only if he objects to any term or condition in the policy. In such a case he is required to return the policy together with the objection in writing, to the insurer within fourteen days (or twenty eight days in the case of a home service policy) after the delivery of the policy to him. Such a policy is deemed to be returned to the insurer when the policy and the objections are received by the insurer or if they are sent by registered post, from the time they are posted⁶³.

As the provisions do not specify the nature of the objection, presumably an insured can object to any term or condition in the policy on any ground. An insurer to

62. Insurance Companies Act 1982 c.31, s.75 and s.76.

63. Insurance Act 1963, s.15D(1) and s.18B(1).

whom such a policy has been returned cannot challenge the validity of the objection. Upon receiving the policy and the objection, the insurer is required to 'forthwith refund any premium which has been paid in respect of the policy which shall thereupon be cancelled'.

Hence, if within fourteen (or twenty eight) days after the receipt of the policy, the insured decides not to proceed with the insurance, all he has to do is to put down in writing his objection to any term or condition in the policy and return the policy together with the objection to the insurer. The insurer is then legally bound to cancel the policy and return his premium.

With some ingenuity, the above provisions can be regarded as indirectly providing the insured with a 'cooling-off period' for life policies. The effective use of this provision however can be hampered by several factors. The average insured may not be aware of these provisions as the insurer is not required to bring them to his notice. Even amongst those who may be aware, the idea of having to prepare a written complaint to be sent to an insurance company may seem a daunting task. Intermediaries might also discourage the insured from exercising such an option in case their commissions might be lost or reduced.

The interest of long-term policyholders can be better

served by having provisions similar to those in England. The insured should be given an unconditional right to cancel the policy within a stipulated time and the existence of such a right must be informed to the insured when the policy is delivered to him. The inclusion of a simple cancellation form together with such information will also greatly help those who may find it difficult to draft their own notices of cancellation.

5.0 Contracts Tainted with Illegality

The Contracts Act draws no distinction between illegal and void contracts⁶⁴. All contracts which are illegal are void. A contract of insurance can be tainted with illegality in a number of ways. Since a contract is illegal if it involves an unlawful purpose or object⁶⁵, a contract of insurance which is intended to serve an illegal purpose will be illegal and void. A contract of insurance may also be illegal if one of the contracting parties is prohibited from entering into such a contract, such as when the insured lacks insurable interest or where the insurer is not registered in accordance with the Insurance Act. A contract of insurance is also

64. The terms 'void' and 'illegal' are used interchangeably in the Act. See eg. s.24 which provides that a contract with an unlawful object or consideration is void. This includes both illegal and void considerations under English law. See generally, Sinnadurai, Op. cit., pp.356 - 358.

65. Contracts Act 1950, s.24.

illegal if it contains a clause in restraint of legal proceedings⁶⁶ or if the events leading to it are tainted with illegality⁶⁷.

S.29 of the Contracts Act provides that any agreement by which any party thereto is restrained from enforcing his rights by the usual legal proceedings in the ordinary tribunals or which limits the time within which he may enforce his rights, is void to that extent. There are a number of exceptions, one of which is that a clause which provides that the parties agree to refer disputes to arbitration is not illegal.

Policies of insurance usually require the insured to make any claim arising thereunder within a specified period. Other policies go a step further by providing that if this is not done, the insurer is absolved of all liability for the loss. The validity of such a clause depends on whether it amounts to a restraint of legal proceedings.

In Corporation Royal Exchange v Teck Guan⁶⁸, the defendant insured his shop and its contents under a fire policy issued by the plaintiff. A fire on 25 November

66. s.29.

67. Asia Insurance Co. Ltd. v American International Assurance Co. Ltd. Op. cit. footnote 43. See also infra. p.74.

68. (1921) 2 FMSLR 121.

1911 totally destroyed the shop and its contents. Details of the claim were submitted to the insurer on 8 December 1911. On 5 January 1912, the insurer wrote to the insured repudiating the policy and denying liability for the loss. On 6 May 1912, the insured filed a suit against the insurer. In denying liability, the insurer relied on Condition 13 in the policy which stated:

If a claim be made and rejected and an action or suit be not commenced within three months after such rejection...all benefits under this policy shall be forfeited.

The Court of Appeal upheld the decision of the trial judge that the clause was void by virtue of s.28 of the Contracts Enactment 1899 of the Federated Malay States which is in pari materia with s.29 of the Contracts Act. According to Sercombe-Smith CJC:⁶⁹

[T]he Limitation Enactment 1896 allows 6 years from the time when a contract in writing is broken within which a suit for compensation for the breach of such a contract will lie.

It seems clear to me that the effect of Condition 13 is to cut down the period within which an assured may bring a suit for compensation for breach of a written contract to a period less than that sanctioned by the Limitation Enactment 1896. This being so, that condition is rendered void to that extent by s.28 of the Contracts Enactment...

A provision similar to that in the Limitation Enactment is found in the present Limitation Ordinance 1953.

69. Ibid. at p.123.

Unfortunately, this provision together with the above decision have neither prevented insurers from including similar clauses in their policies nor prompted the courts to be more wary in giving effect to such clauses⁷⁰. This is clearly illustrated by the case of Chop Eng Thye & Co. v Malaysia National Insurance Sdn Bhd.⁷¹. A clause in a fire policy read:

In no case whatever shall the company be liable for any loss or damage after the expiration of twelve months unless the claim is the subject of pending action or arbitration.

70. In India a similar provision in the form of s.28 of the Contracts Act 1872, has been given a restrictive meaning. The courts there distinguished between agreements which expressly restricted parties from enforcing their rights after the expiry of a specific period of time, and those which had no such restriction but merely provided for a forfeiture or a release of rights if no suits were brought within the stipulated time. Only the former was held to be within the purview of such a provision. In the area of insurance, this distinction is illustrated by two cases, namely Ma Ywet v China Life Insurance Co. (1911) 11 IC 765 and Baroda Spinning and Weaving Co. Ltd. v Satyanarayen Marine and Fire Insurance Co. (1914) ILR 38 Bom. 344. In the first case, a condition in the policy which clearly stipulated that no suit could be brought after one year, was held void under s.28 of the Contracts Act 1872. In the second case, a clause in a fire policy which read: 'If any claim is made and rejected and an action or suit be not commenced within three months after such rejection, all benefits under the policy shall be forfeited' was held to be valid. See further, Pollock and Mulla, Indian Contract and Specific Relief Acts, 9th Ed., Triparthi, Bombay 1972, pp.295 - 296. Such a fine and technical distinction seems both artificial and unnecessary - it allows insurers to manipulate the words used in the policy in order to defeat the provision.

71. Op. cit. footnote 45.

This clause was successfully used by the insurer to defeat the insured's claim. Neither the earlier case of Corporation Royal Exchange nor s.29 of the Contracts Act was considered by the Court.

If the contract of insurance itself is not illegal but the events leading to its formation have an element of illegality, then whether such illegality affects the validity of the contract depends on whether it affects the bargain between the parties, ie. whether the illegality results in the absence of a consensus ad idem between the parties.

In Asia Insurance Co. Ltd. v The American International Assurance Co. Ltd.⁷², Bien Hoe Co. insured their stocks of rubber with the plaintiffs who reinsured part of the risk with the defendant. On a claim under the policy, the plaintiffs paid their total liability and then sought to recover part of that amount from the defendant. The defendant resisted this claim on several grounds one of which was that Bien Hoe had stored the rubber without a licence as required by the Municipal Ordinance and the Rubber Dealers Ordinance. They contended that as Bien Hoe was committing an illegal act in storing the rubber, the policies issued in relation to such storage, including the reinsurance policy, were void.

72. Op. cit. footnote 43.

The plaintiffs argued that this fact did not invalidate any of the policies. Citing inter alia the case of Goulstone v Royal Insurance Co.⁷³, they contended that the fact that an illegal act had been committed in relation to the subject matter of the insurance did not invalidate the contract. Brown J however distinguished the facts in the cases cited from those before him:⁷⁴

[T]he reason for the decision in all these cases was that the illegality which was committed by one of the contracting parties did not affect the bargain which the parties had made...the contracting parties knew what they were bargaining for and got it...

[T]he conditions which precluded the Bien Hoe Co. from obtaining a licence were such that their illegal act...goes to the root of these contracts...

The parties were not ad idem...If the plaintiff did not know of Bien Hoe's illegality, they did not disclose this knowledge to the defendant; and the defendants were not ad idem with the plaintiffs when they entered into the contract of insurance.

Whether the same line of argument can be used in determining the status of a contract of insurance with an unauthorised insurer remains to be seen. So far there has been no reported Malaysian case which challenges the authority of an insurer to enter into such a contract.

In England there are at least three recent decisions with three different solutions to this problem. In Bedford Insurance Co. Ltd. v Instituto de Ressaguros du Brazil⁷⁵,

73. 197 ER 725.

74. Op. cit. footnote 43 at pp.88 - 89.

75. [1984] 1 Lloyd's Rep. 210.

it was held that such a contract was illegal and void. Later, in Stewart v Oriental Fire and Marine Insurance Co.⁷⁶, it was held that the contract was only enforceable by the innocent party, ie. the insured. In Phoenix General Insurance Co. of Greece SA v Halvanon Insurance Ltd.⁷⁷, it was held at first instance that the contract was enforceable by the innocent party and that if the party failed or could not enforce the contract than it could recover damages from the insurer which was equal in amount to what it would have been entitled under the contract, for breach of an implied warranty that the insurer would have the requisite authority to enter into such a contract. This decision was reversed by the Court of Appeal whose decision focussed mainly upon the construction of the related statutory provisions⁷⁸. It remains to be seen how a Malaysian court will react to a similar problem as neither the Contracts Act nor the Insurance Act seem to provide them with any solution⁷⁹.

76. [1984] 2 Lloyd's Rep. 109.

77. [1985] 2 Lloyd's Rep. 599 (HC) and [1986] 2 Lloyd's Rep. 552 (CA).

78. The importance of the Court of Appeal decision in the UK has however been diminished by s.132 of the Financial Services Act 1986. This provision allows the insured to decide whether or not to treat the contract as enforceable. If he decides to treat the contract as unenforceable, he can claim for a return of his premiums as well as compensation for any loss which he has incurred as a result. See further, Birds, J, 'Illegal Contracts Again.', [1987] JBL 49.

79. Under s.24 of the Contracts Act 1950, an agreement is void if its consideration or object is prohibited by law. A contract with an unauthorised insurer does not seem to fall within this category.

CHAPTER THREE

INSURABLE INTEREST

1.0 The Origins of the Concept

The freedom to contract has always been so jealously guarded by the common law courts that even wagering contracts per se were neither unlawful nor unenforceable¹. The courts would only refuse to enforce such a contract if it was intended to encourage immoral acts², was injurious to a third party³ or was contrary to public policy⁴.

With the growth of the insurance industry, insurance was soon conveniently used as a new form of wagering. The common law courts tolerated insurances on ships⁵, entire marine adventures and subsequently on the lives of others by people whose sole interest was to make a quick gain on the occurrence of the insured peril. Where however the courts regarded a particular contract of insurance to be one of indemnity, no claim was allowed if the insured

1. March v Piggot 98 ER 471 and Good v Elliot 100 ER 808.
2. Gilbert v Sykes 104 ER 1045.
3. Da Costa v Jones 98 ER 1331.
4. Atherfold v Beard 100 ER 328, see further, Merkin, R, 'Gambling by Insurance - A Study of the Life Insurance Act 1774', (1890) 9 Anglo-American Law Review 331.
5. Depaba v Ludlow 92 ER 1112.

could not show an interest in the subject matter⁶. To dispense with the requirement of interest, 'Honour Policies' or 'Policy Proof of Interest (P.P.I) Policies' were introduced and clauses such as 'without benefit of salvage to the insurer' were commonly inserted in marine policies.

The abuse and perversion of insurance contracts led to early legislative attempts to rescue the industry from being turned into merely an avenue for gambling. The first attempt was made in 1745 with the passing of the Marine Insurance Act⁷. This Act did not introduce the requirement of insurable interest as such; it merely prohibited the issue of policies which dispensed with proof of interest or policies by way of gaming or wagering⁸.

The first mention of the requirement of insurable interest as a means of combating gambling in the area of non-marine insurance was made in the Life Assurance Act 1774⁹. S.1 of this Act provides that no insurance shall be made where the persons^s to whom such policies are issued have no interest, or ^{are} by way of gaming or wagering.

6. Goddart v Garrett 23 ER 774.

7. 19 Geo.II, c.37.

8. s.1.

9. 14 Geo.III, c.48.

The 1774 Act has numerous limitations. While its expressed purpose was to check 'a mischievous kind of gaming',¹⁰ the Act does not make it an offence for a person to enter into a contract of insurance in which he has no interest, it merely declares such a contract to be null and void. 'Interest' is not defined and the time at which that interest must exist is not specified. The Act also fails to determine the nature of interest that is necessary to satisfy its requirements. These are issues which have subsequently proven to be of utmost importance in this area of the law.

In 1845, the Gaming Act which provides that all contracts or agreements by way of gaming or wagering are void was passed¹¹. As a contract of insurance by someone without an interest is a wager, it is void by virtue of this Act. This Act has a special relevance to certain areas of insurance which are not covered by the earlier Acts, such as insurance on goods.

The final contributions made by the English legislature to the development of the concept of insurable interest

10. See Preamble to the Act.
11. 8 & 9 Vict. c.109, s.18

came in the form of the Marine Insurance Act 1906¹² and the Marine Insurance (Gambling Policies) Act 1909¹³. Under the former, every contract of marine insurance made without interest or by way of gaming or wagering is void¹⁴. It also provides the only statutory definition of the term insurable interest¹⁵. The 1909 Act provides criminal sanctions for persons effecting marine insurance policies without bona fide interest or a bona fide expectation of acquiring an interest in the subject matter. Persons effecting such a policy as well as any broker or person through whom, and any insurer with whom the policy is effected are all guilty of criminal offences¹⁶.

Apart from being intended to be the panacea for gambling by means of insurance, the requirement of insurable interest was also intended to prevent the fraudulent destruction of the subject matter of insurance. The Marine Insurance Act 1745 declared in its preamble that the issue of policies to parties having no interest 'had been productive of many pernicious practices, whereby great numbers of ships, with their cargoes, have either been fraudulently lost or destroyed or taken by enemy in

12. 6 Edw.VII c.41

13. 9 Edw.VII c.12

14. s.4(2).

15. s.5.

16. s.1(2).

time of war'. The Life Insurance Act 1774 in its preamble mentioned the need to prevent 'a mischievous kind of gaming'.

The other justification for the requirement of insurable interest frequently mentioned¹⁷ hinges upon the indemnity nature of certain insurance contracts, ie. that such indemnity contracts can only be maintained by the requirement of insurable interest.

While the requirement of insurable interest might have succeeded in curbing most of the gaming activities at the time the statutes were passed, the prevention of gaming is no longer a valid justification for the requirement of insurable interest - at least not since 1845 in England and since 1899 in Malaysia. The Gaming Act 1845 of England and the Contracts Enactment 1899 of the Federated Malay States¹⁸ made all contracts by way of gaming or wagering null and void irrespective of their nature or content. Since then there is no longer any necessity of requiring an element of interest in insurance contracts

17. See eg. Harnet and Thornton, 'Insurable Interest in Property: A Socio Economic Re-evaluation of a Legal Concept', (1948) 48 Columbia LR 1162 and Editorial Note, 'Insurable Interest in Property: An Expanding Concept', (1958-59) 44 Iowa LR 513.

18. At present in Malaysia provisions similar to that in the Gaming Act are found in s.31(1) of the Contracts Act 1950 and s.27 of the Civil Law Act 1956. See infra. pp.93 - 94.

over and above that required by these statutes.

Even in the absence of statutes prohibiting wagers, it is extremely doubtful to what extent the requirement of insurable interest can effectively curb gaming. Only the Marine Insurance (Gambling Policies) Act 1909 (UK) makes it an offence to purchase, issue or otherwise deal with policies where there is no insurable interest. There are no similar provisions in relation to non-marine insurance and although it takes two parties to wager, the insured bears all the consequences of taking out a policy without insurable interest. The issue of policies without interest cannot be effectively curbed if the insurer is not only not penalised but in fact allowed to accept the premiums and then decide whether to raise the absence of insurable interest as a defence to the insured's claim.

Even if the requirement of insurable interest still does to a limited extent prevent gaming, there are other areas in which insurance law neutralises such an effect. The law allows a life policy to be assigned and re-assigned ad infinitum to anyone the assignor chooses and the assignee is not required to have any insurable interest in the life insured. An assignee of a policy on the life of another can be as much a gambler as another who takes out a policy on the life of someone in whom he

has no insurable interest.

The prevention of fraudulent destruction of the subject matter of insurance as a justification for the requirement of insurable interest is also not without weaknesses.

The criminal law of both England and Malaysia in fact adequately protect persons and property from such unlawfully inflicted harm or destruction. Insurable interest can only possibly play a peripheral role in this respect, by removing one of the incentives for the commission of such crimes. It may also discourage the commission of crimes by the use of long-drawn and subtle methods where both mens rea and actus reus may be difficult to prove.

It is also grossly unfair and extremely naive to presume that everyone who takes out a policy without insurable interest is a potential criminal while everyone who can show such interest is free from criminal intentions. In property insurance, it may not always be possible to show interest at the inception of the policy either because the existence of the subject matter or the existence of a legally recognised relationship between the insured and the subject matter cannot at that time be clearly

identified. In life insurance it would be simplistic to assume that a potential criminal would insure the life of someone in whom he has no insurable interest for the purpose of making a quick gain. It would be less suspicious for him to take out a policy on someone in whom he in fact has an insurable interest.

There is also in existence in both England and Malaysia as in most other countries, the principle that a person cannot benefit from his own crime. The application of this universal legal principle is in itself sufficient to prevent the commission of crimes for the purpose of making insurance claims. In fact this principle is more effective in preventing fraudulent destruction because it is applicable across the board and does not presume that the temptation to destroy for the purpose of financial gains plagues only those without insurable interest in the subject matter to be destroyed.

The principle of indemnity in relation to insurance means that the insurer is supposed to make good, in pecuniary terms, the loss suffered by the insured and the insured cannot recover more than he loses. The requirement of insurable interest however is neither the sole nor the most effective yardstick for determining this. Rather than support the principle of indemnity, the requirement of insurable interest can sometimes destroy it, because

whether a person suffers a loss on the occurrence of the insured event does not always depend upon the existence of such an interest. This is clearly illustrated by Macaure v Northern Assurance Co.¹⁹. Macaure, the sole shareholder of a limited company, had lent substantial sums of money to that company, so he insured, in his own name, timber which was owned by the company. Although the loss of the timber would have resulted in the value of Macaure's shares in the company to fall, the House of Lords held that Macaure as a shareholder had no insurable interest in the timber owned by the company.

While the main criticism against the requirement of insurable interest in indemnity policies is that it does not always effectively promote indemnity, the alternatives too are not without their limitations. Although a principle of compensation for actual losses which results from the insured event, up to the maximum amount insured seems attractive, its implementation may prove difficult without an element like insurable interest which links the losses to the insured event. The use of vague formulas based on reasonable foresight, proximity or direct consequence may be even more problematic and perhaps open the floodgates of litigation

19. [1925] AC 619.

even further. One solution which has been considered and in fact adopted in several countries is to alter the definition of insurable interest from one that requires proprietary interest to a more flexible one that recognises lawful and substantial economic interest²⁰.

2.0 Sources of the Law Relating to Insurable Interest

2.1 The Law in England

The law on insurable interest in England today consists of the statutory provisions as mentioned earlier coupled with the case law that has since evolved. Where statutory provisions are exhaustive, such as in marine insurance, the cases merely illustrate the application and interpretation of such provisions. In areas such as life and property insurance where statutory provisions merely provide the bare skeleton of the law, case law forms an extremely important source of this aspect of the law.

In the area of marine insurance, provisions relating to insurable interest are found in the Marine Insurance Act 1906. S.4(1) declares every contract of marine

20. Australian Law Commission Report No.20, Insurance Contracts, (1981-82) Vols. 19-21, pp.72-73, paras. 118-120.

insurance by way of gaming or wagering void. S.4(2) provides that a contract made without interest or without an expectation of acquiring an interest is void. A person has an interest in a marine adventure 'where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss or by damage thereto...'²¹

The requirement of insurable interest in life and property insurance is based on the Life Insurance Act 1774 but this Act has not had the same effect on life and property insurance as the 1906 Act had on marine insurance. The 1774 Act merely states in general terms that insurance without interest or by way of gaming or wagering are void²². It also provides that it shall not be lawful for policies to be made without inserting the name or names of the person or persons interested in the policy²³ and that no greater sum shall be recovered from the insurer by the insured than the amount of the value of his interest in the subject matter of the insurance²⁴.

21. s.5(2).

22. s.1.

23. s.2.

24. s.3.

The brevity and generality of the provisions of the 1774 Act has resulted in the development of a considerable body of case law in this area. For instance, although the Act does not state when interest must exist, it is now the law that in life insurance, insurable interest must be shown to exist only at the inception of the contract²⁵. This interest must be of a pecuniary nature²⁶ and following the definition in the Marine Insurance Act 1906²⁷, this pecuniary interest must be based upon a legal or equitable relationship. Insurable interest is presumed to exist and proof thereof is dispensed with when a person takes out a policy on his own life²⁸ or on the life of his spouse²⁹.

The 1774 Act also applies to insurance on property other than goods and merchandises³⁰. As such insurance is one of indemnity, interest thereof must not only be shown to exist at the inception of the policy, as is required by the Act, but also at the time of the loss³¹.

There are no specific statutory provisions requiring

25. Dalby v India and London Life Assurance Co. 139 ER 465.

26. Halford v Kymer 109 ER 619.

27. s.5(2).

28. Wainright v Bland 150 ER 334.

29. Griffiths v Fleming [1909] 1 KB 805 and M'Farlane v The Royal London Friendly Society (1886) 2 TLR 755.

30. s.1 and s.4.

31. Sadler's Co. v Badcock 26 ER 733.

insurable interest in non-marine insurance on goods and merchandises. However this does not mean that insurable interest is irrelevant to such policies for contracts of insurance without interest are wagers and are void under the Gaming Act 1845. Hence some form of interest must be shown at the inception of the contract. And as an insurance on goods is based on the principle of indemnity, interest must also be shown at the time of the loss.

2.2 The Law in Malaysia

The law relating to insurable interest in Malaysia is a reflection of the extent to which early English statutes, the common law and local statutes can all contribute to the moulding of just one legal concept.

Prior to the passing of the Insurance Act 1963, there were no local statutory provisions relating to insurable interest. There were, however, already in existence provisions declaring agreements by way of wagers to be void. Such a provision was found in the earliest version of the Contracts Act, ie. the Contracts Enactment 1899. S.31 of the present Contracts Act 1950 is identical to the earlier provision and is similar to s.18 of the Gaming Act 1845 (UK). The Civil Law Act 1956 also

contains a similar provision³².

A drastic change to the law of insurable interest in life insurance was introduced by the Insurance Act 1963. Although essentially regulatory in nature, this Act introduced a few radical changes to the substantive law. One such change is in relation to insurable interest in life insurance³³.

Assuming that the provisions in the English statutes are applicable, there are in Malaysia six different statutes which either directly or indirectly, provide the basis for the law relating to insurable interest. They are the Life Insurance Act 1774 (UK), the Marine Insurance Act 1906 (UK) and the Marine Insurance (Gambling Policies) Act 1909 (UK), the Insurance Act 1963, the Contracts Act 1950 and the Civil Law Act 1956.

2.2.1 The Applicability of English statutes

There being no parallel local statutes, the Marine Insurance Act 1906 (UK) and the Marine Insurance (Gambling Policies) Act 1909 (UK) are applicable in Malaysia by virtue of s.5 of the Civil Law Act 1956. These Acts provide the law relating to insurable interest in marine insurance.

32. See infra. p.95.

33. See infra. p.93.

While prior to 1963 the Life Insurance Act 1774 (UK) was applicable in toto by virtue of the same provision of the Civil Law Act, the same may no longer be the case. The 1774 Act is applicable to life as well as property insurance except those on 'goods and merchandises'. While s.40 of the Insurance Act 1963 has introduced a provision relating to insurable interest in life insurance, there is nothing in that Act in relation to insurable interest in the other areas to which the 1774 Act is applicable. One possible deduction that can be made from this is that s.40 has completely replaced the provisions of the 1774 Act as far as life insurance is concerned. Thus paradoxically the Life Insurance Act 1774 (UK) is only applicable in Malaysia in relation to non-life policies, excluding those on 'goods and merchandises'. The other possible deduction is that as s.40 does not conflict with the provisions of the 1774 Act, this provision has not replaced the latter but has merely widened its scope. Thus in the area of life insurance, the provisions of both the Acts should be read together. This deduction can be supported by the fact that the 1963 Act does not, either in s.40 or elsewhere, make any reference to the 1774 Act, so the 1774 Act has not been repealed either wholly or in parts. The 1963 Act is also not a code on insurance law but is mainly an Act to regulate the business of insurance. It has not introduced a completely new law of insurance. Therefore

in the absence of a provision to that effect, it cannot be presumed that this Act has repealed the 1774 Act.

2.2.2 S.40 of the Insurance Act 1963

The two most important provisions of s.40 are subsections (1) and (2). They read:

(1) A life policy insuring the life of anyone other than the person effecting the insurance or a person connected with him as mentioned in subsection (2) shall be null and void unless the person effecting the insurance has an insurable interest in that life at the time the insurance is effected; and the policy moneys paid under such a policy shall not exceed the amount of the insurable interest at that time.

(2) The lives excepted from subsection (1), besides that of the person effecting the insurance, are those of that person's child or ward being under the age of majority at the time the insurance is effected, and of anyone on whom that person is at that time wholly or partly dependent.

S.40 has an obscure and mysterious history. It was in the original Bill that was tabled in Parliament but was not in the Draft Proposal of the Act in the Report Upon Insurance Legislation for the Federation of Malaya as was submitted by SW Caffin in 1960³⁴.

34. Caffin, SW, Report Upon Insurance Legislation for the Federation of Malaya, 1960. SW Caffin was a former Insurance Commissioner of Australia who was appointed by the government of the Federation to prepare the Report and to draft a comprehensive insurance legislation.

The Minister of Finance when tabling the Insurance Bill justified the inclusion of s.40 in the following words:³⁵

It is well known that much of the business of the 'mushroom' life insurance companies consisted of policies closely akin to gambling. People insured the lives even of beggars in the street in the hope that they would die at an early date. The passing of the Bill will end this sort of thing. If a person does not have a pecuniary interest (what is in law called an insurable interest) in the life of another, any policy effected by him on the life of that other person shall be void. Exceptions to these are policies effected by a wife on the life of her husband, by a husband on the life of his wife, parents on the lives of their children and guardians on the lives of their wards.

While the above justification might have been valid in the days prior to 1774, it is submitted that such a justification was not valid at the time when the Bill was introduced. Even prior to 1963, the Life Insurance Act 1774 (UK) together with the English cases were applicable in Malaysia. There were also already in existence provisions relating to wagers in both the Contracts Act 1950 and the Civil Law Act 1956. The proliferation of the 'mushroom' companies was not because of any defects in the law relating to insurable interest but because there was hardly any regulation or supervision over the growth of such companies. The 1963 Act has introduced various effective measures for the regulation and control

35. Dewan Rakyat Debates, 22nd December 1962, Government Printers, Kuala Lumpur 1962, p.3880.

of insurance companies, but s.40 does not and cannot serve such a purpose.

2.2.3 Statutory Provisions on Wagering Contracts

S.31(1) of the Contracts Act 1950 reads:

Agreements by way of wagers are void; and no suit shall be brought for recovering anything alleged to be won on any wager, or entrusted to any person to abide the result of any game or other uncertain event on which any wager is made.

The above provision seems to share common deficiencies with s.18 of the Gaming Act 1845 of England. Both merely declare agreements by way of wagers to be void but do not make them illegal³⁶. There are no penalties in either of the provisions for persons entering into such agreements.

A wager is not defined in either of the provisions. The classic definition of a wager which has not only been affirmed by the Court of Appeal³⁷ but has also been accepted by leading writers³⁸ is that given by Hawkins J

36. Seong Sam v Goon Food On (1933-34) FMSLR 169.

37. [1893] 1 QB 256.

38. See eg. Guest, AG, (Ed.) Anson's Law of Contract, 25th Ed., Clarendon, Oxford 1979, p.334 and Furmston, MP, (Ed.), Cheshire Fifoot & Furmston's Law of Contract, 11th Ed., Butterworths, London 1986, p.308.

in Carlill v Carbolic Smoke Ball Co.³⁹:

A wagering contract is one by which two persons, professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent on the termination of that event, one shall win from the other, and the other shall pay or hand over to him, a sum of money or other stake; neither of the contracting parties having any other interest⁴⁰ in that contract than the sum or stake he will so win or lose, there being no other real consideration for the making of such contract by either of the parties.

The absence of any other real interest in the contract apart from the wager itself distinguishes wagering contracts from insurance contracts. Furthermore, in a wager the intention is to create a speculative risk upon which to wager. In an insurance contract the intention is to transfer an existing risk from one party to another. Thus while a wager results in loss to one party and gain to another, insurance results in the payment of compensation to a party that has suffered loss by another who has been paid the premium for so doing.

In insurance the element of insurable interest forms that 'other interest' that distinguishes insurance contracts from wagers. If this 'other interest' is absent, then a contract of insurance can no longer be distinguished from a wager and thereby falls within the scope of a provision

39. [1892] 2 QB 484 at p.490.

40. Emphasis added.

like s.31(1). Thus even in the absence of a specific requirement of insurable interest every contract of insurance must have some kind of interest so as to distinguish it from wagers and to bring it outside the purview of a provision against wagers. This interest however is wider and more general in its scope than insurable interest in insurance law. Although not defined in s.31(1), 'interest' here seems to be used in its ordinary, non-technical and non-legal context. It should therefore include not merely interest which is based on a legally enforceable right as is the accepted notion of interest in insurance law⁴¹, but also interest based on the broader concept of factual expectation. A contract of insurance which does not contravene s.31(1) cannot therefore be automatically presumed to have satisfied the requirement of insurable interest.

It is noteworthy that apart from s.31(1) of the Contracts Act, s.26 of the Civil Law Act 1956 also declares agreements by way of wagers to be void. The courts however have almost always referred to the provision in

41. Macaura v Northern Assurance Co Op. cit., footnote 19. However in the Canadian case of Constitution Insurance Co. of Canada v Kosmopoulos, (1987) 34 DLR (4th) 208, where the facts are almost identical to that in Macaura, the Canadian Supreme Court applied the factual expectation theory and held that the sole shareholder of a company had an insurable interest in the company's property. See further, Birds, J, [1987] JBL 309.

the Contracts Act rather than the one in the Civil Law Act in dealing with wagers⁴².

3.0 Insurable Interest Defined

In general terms insurable interest is the particular relationship or nexus between the person taking out an insurance policy and the subject matter of the insurance which must exist for there to be a valid contract of insurance. It is in determining which relationships are recognised and which are not that a more exhaustive definition is called for.

The Insurance Act 1963 does not define insurable interest. Neither can a definition be found in the few Malaysian cases on this aspect of insurance law. The only statutory definition of this concept in Malaysia, as in England, is found in the Marine Insurance Act 1906 (UK):

S.5(1) Every person has an insurable interest who is interested in a marine adventure.

S.5(2) In particular a person is interested in a marine adventure when he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein; in consequence of which he may benefit by the safety or due arrival of the insured property, or he may be prejudiced by its loss or by damage thereto, or by the detention thereof, or may incur liability in respect thereof.

42. This can be perhaps be explained by the fact that while the Contracts Act deals specifically with contracts, the Civil Law Act is more general in its nature; see the Long Titles of both Acts.

As opposed to the statutory definition there is the definition given by Lawrence J in Lucena v Craufurd:⁴³

A man is interested in a thing to whom advantage may arise, or prejudice happen from the circumstances which may attend to it...

[I]nterest does not necessarily imply a right to the whole, or part of a thing, nor necessarily or exclusively that which may be subject of privation, but having some relationship to, or concern in the subject of insurance, which relation or concern by the happening of the perils insured against may be so affected as to produce a damage, detriment or prejudice to the person insuring; and where a man is so circumstanced with respect to matters exposed to certain risks or dangers, as to have a moral certainty of advantage or benefit ... To be interested in the preservation of a thing, is to be so circumstanced with respect to it as to have benefit from its existence, prejudice from its destruction.

The definitions given above represent the two opposing views as to the exact scope of insurable interest. While the statutory definition emphasises the existence of a legal or equitable right, that given by Lawrence J is based on the wider premise of factual expectation of detriment from the loss or destruction of the property or advantage from its continued existence.

The factual expectation theory was first articulated by Lord Mansfield in Le Cras v Hughes⁴⁴ which was decided

43. 127 ER 630 at p.642.

44. 99 ER 549.

twenty four years before Lucena v Crauwford. Since then however this definition has hardly ever been utilised in England as the English judges have always insisted on the existence of a legally enforceable right⁴⁵.

In Malaysia no case has arisen which requires the court to decide which of the two definitions to adopt. Should such a situation arise it is highly probable that following the Marine Insurance Act 1906 (UK) and the judicial trend in England, the definition^{it} based on a legally enforceable right will be adopted.

4.0 Insurable Interest in Life Insurance

Under English law there are two basic rules governing insurable interest in life insurance. First, for there to be^{an} insurable interest there must be pecuniary interest of some kind. Second, insurable interest is presumed to exist when a person insures his own life or that of his spouse⁴⁶.

S.40 of the Insurance Act retains the first rule and enlarges the second. Insurable interest is presumed to exist not only when a person insures his own life or that

45. Supra. p.84.

46. Op. cit. footnotes 28 and 29.

of his spouse, but also when he insures the life of his child or ward who is below the age of majority at the time the insurance is effected and when he insures the life of anyone upon whom he is at that time wholly or partly dependent.

4.1 Insurable Interest in One's Own Life

The Life Insurance Act 1774 (UK) itself makes no exceptions to the requirement of insurable interest in life insurance. The common law however has long recognised that insurable interest need not be proven when a person insures his own life⁴⁷. The requirement of insurable interest in such a situation could not have been justified either by the aim of avoiding wagers or preventing destruction. A man would not commit suicide to get insurance moneys not for himself but for his estate⁴⁸.

In Malaysia the common law principle has been given statutory recognition. While s.40 of the Insurance Act refers to a policy insuring the life of anyone 'other

47. In M'Farlane v The Royal London Friendly Society (1886) 2 TLR 755 at p.756, Pollock B said that there was nothing to prevent any person from insuring his own life a hundred times.

48. The insurance by a man on his own life is not within the mischief of the Act as a man does not gamble his own life to gain a Pyrrhic victory by his own death, per Kennedy LJ in Griffiths v Fleming [1909] 1 KB 805 at p.821.

than the person effecting the insurance', s.40(2) lists the lives excepted from subsection (1) 'besides that of the person effecting the insurance'.

4.2 Insurable Interest in the Life of One's Spouse

Under the common law this is the only family relationship where the existence of insurable interest is presumed. The fact that a husband is presumed to have an insurable interest in the life of his wife and that it was unnecessary to give affirmative evidence to that effect was first recognised in Griffiths v Fleming⁴⁹ where it was held that insurable interest was to be presumed irrespective of whether the husband did or did not depend upon his wife in the pecuniary sense⁵⁰. The same is true as regards the interest of the wife in the life of her husband. It was held in Reed v Royal Exchange Assurance Co.⁵¹ that a wife insuring the life of her husband need not prove that she had an interest therein.

In Malaysia s.40(2) provides that one of the exceptions to the requirement of insurable interest is when a person

49. Ibid.

50. Griffiths v Fleming was decided after the Married Women's Property Act 1882 was passed. Prior to the passing of this Act a wife was the property of her husband. See generally, Holcombe, L, Wives and Property, Martin Robertson, Oxford 1983.

51. 170 ER 198.

effects a policy on the life of his or her spouse. Thus in this area too the law does not materially differ from that in England. However the application of this principle amongst Muslims in Malaysia may result in some practical differences. A Muslim marriage being polygamous, a Muslim man can have up to four wives at any one time. This means that a man who in fact has four wives is presumed to have an insurable interest in the lives of all his wives. As the law requires that such an interest be shown to exist only at the inception of the policy, if he divorces all the four and marries another set of four, he is able to insure the lives of all his new wives whilst retaining the policies on his ex-wives.

4.3 Insurable Interest in the Lives of One's Minor Children and Wards

It is in relation to insurable interest in the lives of one's minor children and wards that s.40 of the Insurance Act radically changes the common law. Under the common law, the case of Halford v Kymer⁵² made it clear that in the absence of evidence of pecuniary interest, a parent does not have an insurable interest in the life of his minor child. Neither does a guardian in the life of his ward. S.40(2) exempts from the requirement of insurable

52. Op. cit. footnote 26.

interest, a policy taken out by a person in the life of his minor child or ward who is below the age of majority⁵³ at the time the policy is effected.

The origin and rationale of this provision is unclear. Interestingly the Life Insurance Act 1945 of Australia has a similar though not identical provision. S.86(1) of the Australian Act provides that a parent of a child under twenty one years of age, or a person in loco parentis with such a child has an insurable interest in the life of that child.

As the raison d'etre for the introduction of the above provision has never been explained, what could have so strongly motivated the legislature to introduce a provision which represents a departure from the established common law principle remains a mystery. In all the other relationships where insurable interest is presumed to exist under s.40, there runs a common connecting thread, ie. there is some form of dependence whether pecuniary or otherwise, by the person insuring upon the life insured. The same form of dependence cannot be said to be present in a parent - minor child or

53. According to s.2 of the Age of Majority Act 1971, a child attains the age of majority on his 18th birthday.

guardian - minor ward relationship. The dependence if any in such a relationship is that of the child or ward upon the life of his parent or guardian, rather than the reverse. Parents and guardians are certainly not pecuniarily dependent upon such child or ward. Neither can it be logically said that they are emotionally dependent upon the lives of such children or wards in the same way as they are so dependent upon the lives of their spouses. If the contrary is to be presumed then the law should not discriminate between children who have attained the age of majority and those who have not.

Similarly, if the justification for such a provision is based upon the extremely vague notion of 'expected dependence', ie. that the parent or guardian having taken care of the minors are entitled to expect to depend upon them for pecuniary returns in future, then again this provision should not be restricted to minor children and wards only. Parents and guardians often support the children long after they have reached the age of majority.

If the reason for presuming insurable interest in such policies is to enable the parent or guardian to provide for the future security of such a child or ward, then there are other more effective ways of doing so. One

such means was suggested by Bayley J in Halford v Kymer:⁵⁴

If a father, wishing to give his son some property to dispose of, makes an insurance on his son's life in his (son's) name, not for his (the father's) benefit, but for the benefit of his son, there is no law to prevent his doing so ...

In Malaysia s.41 of the Insurance Act in fact allows a child above the age of ten years to enter into a contract of insurance provided that if he is under sixteen years of age he must have the written consent of his parent or guardian⁵⁵.

Provisions for the future security of the child can also be effected by means of a trust policy under s.23 of the Civil Law Act, ie. by the parent taking out a policy on his own life and naming the child as a beneficiary⁵⁶.

A parent or guardian is also free to assign a policy on his own life to his child once the child has reached the age of majority.

There therefore seems to be no valid justification for presuming the existence of insurable interest on the part

54. Op. cit. footnote 26 at p.621.

55. See Chapter Two - Contractual Formalities.

56. See Chapter Ten - Assignments and Trusts.

of a parent or guardian in the life of his child or ward. Such a provision in fact defeats one of the very justifications for the requirement of insurable interest, ie. the removal of the temptation to destroy the subject matter of the insurance on the part of the insured. The presumption that a parent or guardian has an insurable interest in his child or ward may only encourage child neglect and abuse as there is little to prevent a parent having taken out a policy on the life of his child to neglect or even to use other subtle means to hasten the child's death.

In England, in the past, it was common practice for parents to effect child's deferred assurance on the life of a child. Apart from being in breach of the requirement of insurable interest, such policies had several disadvantages. Parents could not get tax relief on such policies; the title to the policy remained vested in the parents unless the policy was effected by him as a trustee for the child or the policy had been assigned to the child. There were also uncertainties as to whether the parent was entitled to take a loan or surrender such a policy during the deferred period⁵⁷.

57. Davies, BPA, Houseman & Davies Law of Life Assurance, 10th Ed., Butterwoths, London 1984, p.277.

The contemporary practice in England is for the parent to effect a child's deferred assurance which is designed either to provide a cash sum to the child when he attains a certain age or to enable the child to convert it into a policy on his own life at a low rate of premium⁵⁸. As such a policy is effected not on the life of the child but on that of the parent no question of insurable interest arises. The premium will cease if the parent dies before the child reaches the specified age. The parent is also entitled to tax relief on the premium.

In Malaysia it is still very common for parents to effect child's deferred assurance on the life of their child even though there is no tax relief for premium paid on the life of a child⁵⁹. By virtue of s.40(2) however, such policies, unlike those issued in England in the past, are issued not in breach of the requirement relating to insurable interest.

4.4 Insurable Interest in the Life of a Person on whom One is Wholly or Partly Dependent

Finally, insurable interest is deemed to exist under s.40(2) when a person takes out a policy on the life of

58. Ibid. at p.278.

59. Lee, KK, Life Insurance in Malaysia, Life Insurance Association of Malaysia, Kuala Lumpur 1984, pp.23 - 24.

another on whom he is either wholly or partly dependent. Assuming that its rationale is defensible, the primary weakness of this provision is its generality. 'Persons on whom one is either wholly or partly dependent' is so broad and vague in its meaning that it is difficult to determine with certainty which relationships come within its purview and which do not.

The degree of dependence that is required is also not reflected in this provision. While 'wholly dependent' may be clear in its meaning, 'partly dependent' can range from minimally dependent to totally dependent. Furthermore it is not clear if this dependence must be exclusively pecuniary in nature or whether emotional or physical dependence may also suffice. Whatever the nature of the dependence, there is then the further question of whether it must be based on a legally recognised relationship or whether mere factual dependence is sufficient.

Because of its extreme generality and because this provision has yet to be tested in a court of law, the actual scope of this particular provision in s.40(2) remains a matter for speculation. For instance has a paraplegic who depends upon the generosity of his neighbour to cook his evening meals, an insurable

interest in the life of that neighbour? And has a younger brother an insurable interest in the life of his elder sibling upon whom he depends for pocket money?

It is also not clear whether this provision covers policies taken out by a company in the lives of its key personnel - the so-called 'key man insurance'. If partial or total dependence is the sole criteria than there certainly is such dependence by the companies upon their key employees. Perhaps the answer to this question hinges upon whether the phrase 'any person' in S.40(2) is wide enough to include not just individuals but companies and other corporate entities.

In spite of the numerous uncertainties as to its precise scope, certain types of relationships will definitely be within the scope of this provision. A child who is dependent on his parent or other relatives for support and education can certainly be deemed to have an insurable interest in the life of the parent or relative. Similarly parents who are dependent upon their children for financial support will also come within this provision. Outside the sphere of family ties, it is submitted that a common law wife can be presumed to have an insurable interest in the life of the of the man who supports and maintains her. Homosexual couples too should be able to insure the lives of their partners

without having to prove pecuniary interest. All these and other relationships that come within the category of total or partial dependence should come within the scope of this provision. To what extent the Malaysian courts will be willing to give a liberal interpretation to this provision and to regard its vagueness as providing this area of the law with a degree of flexibility remains to be seen.

S.86(1) of the Life Insurance Act 1945 of Australia has a similar though much narrower provision. A person is deemed to have an insurable interest in the life of another upon whom he is either wholly or partly dependent for support or for education. In stipulating the nature of the required dependence, the Australian provision is much clearer though more restrictive in its meaning.

4.5 Insurable Interest in the Lives of Others

The Insurance Act has not changed the common law as regards insurable interest in the lives of persons other than those considered earlier. In all other circumstances therefore, whether a person has an insurable interest in the life of another depends on whether he has a pecuniary interest in the life of that person. Presumably particular situations where insurable interest has been held to exist under the common law will also be so held in Malaysia. A creditor, for instance, has an insurable

interest in the life of his debtor⁶⁰ and where there is a contract of employment, the employee has an insurable interest in the life of the employer to the extent of the contract⁶¹ and so does the employer in the life of the employee⁶². The sole determinant in all these situations is whether there exist a pecuniary interest based on a legally enforceable relationship.

4.6 Time at which Insurable Interest must Exist

The Life Insurance Act 1774 (UK) does not stipulate the time at which insurable interest must exist. The courts however have, in the case of Dalby v The India and London Life Assurance Co.⁶³, by overruling the earlier decision in Godsall v Boldero⁶⁴, made it clear that interest must exist at the inception of the policy. This is also the position under s.40(1) of the Insurance Act.

By endorsing the decision in Dalby and incorporating it into a statutory provision, the question as to when insurable interest must be shown to exist in life policies has been made 'judge-proof'. The wisdom and utility of converting a case law into a statutory

60. Godsall v Boldero 103 ER 500.

61. Hebdon v West 122 ER 218.

62. Green v Russell [1959] 2 All ER 525.

63. 139 ER 465.

64. Op. cit. footnote 60.

provision is dubious. Case law can react more quickly to changes in the commercial world. Judges are known to have reinterpreted, overruled and widened the scope of existing decisions.

Even in the absence of any statutory provision incorporating it, the decision in Dalby would have been the law in Malaysia anyway. By having a crude provision requiring insurable interest to exist at the time the insurance is effected, the legislature has overlooked much of the subtlety of the decision in Dalby. It has been said that in Dalby there was not merely interest at the time the policy was effected but there was also then an expectation that the interest would subsist until the occurrence of the insured event, ie. the death of the Duke⁶⁵. When the policy was effected there was not merely an insurable interest in existence but there was also a reasonable expectation that such interest would continue to exist until the occurrence of the insured event. The fact that the interest would not actually last until that time was not then foreseeable.

The decision in Dalby is therefore only an authority for

65. MacGillivray, EJ, MacGillivray and Parkington on Insurance Law, 7th Ed., Sweet & Maxwell, London 1981, p.15.

the narrower principle that if there is insurable interest at the inception of the policy coupled with a reasonable expectation that this interest will subsist throughout the duration of the policy, then it matters not if in fact there is no interest at the time of the loss. The expectation of the continued existence of the insurable interest until the time of loss is important as it effectively replaces the indemnity principle in ensuring that life policies are not used for wagering. It serves as a sieve to separate the gamblers from persons with a bona fide interest in the life insured.

By requiring interest only at the time the policy is effected, s.40(1) has not only failed to accurately reflect the common law but has also brought the law in Malaysia in this respect to a standstill while the common law remains open to continued interpretation.

4.7 Insurable Interest and the Amount Recoverable under a Life Policy

S.40(1) of the Insurance Act provides that the policy moneys paid under a life policy shall not exceed the amount of the interest at the time the policy was effected. The Life Insurance Act 1774 (UK) on the

contrary does not state the time at which the value of the interest is to be determined; it merely provides that the amount recoverable from the insurer shall not be greater than the amount of the value of the insured's interest⁶⁶. As according to Dalby as long as insurable interest exists at the inception of the policy, the full policy moneys are payable on the occurrence of the insured event irrespective of pecuniary loss, the effect of the two provisions seem to be the same. Both underline the fact that a contract of life insurance is not one of indemnity.

4.8 Effect of the Absence of Insurable Interest on a Life Policy

Inspite of the fact that the purpose behind the introduction of s.40 was to prevent gambling on people's lives, the Insurance Act imposes no penalty for the contravention of s.40. A contract of life insurance made in contravention of that provision is void but if the insurer agrees to honour such policies, there is no way for the state to effectively check such practices.

For the Insurance Act which is almost two centuries younger than the Life Insurance Act 1774 (UK) to repeat

66. s.3

the omission of the 1774 Act in not including a penalty for persons entering into contracts of life insurance without insurable interest is regrettable. Long before the Insurance Act was passed it was already clear that the primary defect of the 1774 Act is its failure to impose such a penalty.

5.0 Insurable Interest in Non-Life Insurance

5.1 Insurable Interest in Insurance on Goods

The absence of any specific statutory requirement of insurable interest in insurance on goods does not mean that this concept is totally irrelevant in this branch of insurance. Some form of interest must be shown in an insurance on goods by virtue of two distinct principles of law. The first is the unenforceability of agreements by way of wagers and the second is the indemnity nature of such an insurance. While the first principle requires some form of interest at the inception of the policy, the second requires interest at the time of the occurrence of the insured event.

The requirement of interest at the inception of a goods policy was explained by Lord Pearce in Hepburn v Tomlinson:⁶⁷

67. [1966] AC 451 at p.477.

The Life Insurance Act, 1774, extended similar principles to other contracts of insurance, but excepted insurance on goods against land risk. These, although made without interest were enforceable until 1845 when the Gaming Act was passed. That Act rendered void all contracts which in substance are wagers made without interest in the subject matter of the insurance. Thus if insurance was effected by a person without insurable interest he could not recover.

By replacing the Gaming Act 1845 (UK) with either the Contracts Act 1950 or the Civil Law Act 1956 (both of which contain provisions similar to that in the 1845 Act) the above statement is equally applicable in the Malaysian context.

A person who has a legal or equitable right over the goods has an insurable interest in such goods. This includes not merely the owner of the goods but also persons having other identifiable legal or equitable relationship with the goods. A bailee for instance, has an insurable interest and can insure the full value of the goods provided he holds the proceeds in trust for the owners⁶⁸. As a general rule, possession of the goods coupled with a degree of legal responsibility over them provides a basis for the existence of insurable interest in such goods⁶⁹.

68. Waters v Monarch Fire and Life Assurance Co. 119 ER 705 and Hepburn v Tomlinson, Ibid.
69. Robertson v Hamilton 104 ER 701.

In one of the few local cases on insurable interest it was held that an executor de son tort has an insurable interest in the goods belonging to the deceased. The plaintiff in Pacific and Orient Insurance Co. Sdn. Bhd. v Lim Sew Chong & Anor.⁷⁰ sought a declaration that a policy issued by them to one Ng Hwee Bin, deceased, in respect of a lorry was void. The defendants were the administrators of the deceased's estate. The said policy was issued at the request of Ng Moh Chee, the deceased's son, after his father's death. The proposal form was signed by Ng Moh Chee and in the column for the proposal's name he wrote 'Ng Hwee Bin - Deceased'. On every occasion when the policy was renewed Ng Moh Chee always disclosed to the plaintiff's agent that his father who owned the lorry had died and that he (Ng Moh Chee) was managing his father's estate. The plaintiff sought to avoid the policy inter alia on the ground that as Ng Moh Chee was not the registered owner of the lorry, he had no insurable interest therein. It was held that in managing the estate of his deceased father, Ng Moh Chee had assumed the role of an executor de son tort and as such he had an insurable interest in the lorry.

An interesting side feature of the above case is the fact that it was generally assumed by the court that a policy

70. [1985] 2 MLJ 60.

on the lorry was a goods policy. This may seem correct in the light of what was said by Roche J in Williams v Baltic Insurance Association:⁷¹

A motor car is the subject matter of the insurance, and a motor car is a chattel or goods ...

However, the policy in Williams was a comprehensive policy, covering not only liability to a third party but also loss or damage to the car itself and it was this fact that was used by Roche J to support his finding:⁷²

This is an insurance on the motor car, although incidentally the policy contains provisions as to third party risks.

The policy in the Pacific and Orient case was, on the contrary, strictly and exclusively a policy against third party risks. It should therefore have been regarded as a liability insurance rather than a goods insurance.

Another important issue in relation to insurable interest in goods is the effect of either an agreement to sell or a contract of sale on such interest, ie. when the interest of the seller ceases and when the interest of the buyer commences. This question was considered by the

71. [1924] 2 KB 282 at p.290.

72. Ibid.

Federal Court in Nanyang Insurance Co. Ltd. v Salbiah and Anor.⁷³. A car was bought by one Lau and was duly registered and insured in his name with the appellant. Subsequently Lau entered into an agreement to sell the car to one Karim for (M)\$3,400. The first instalment of (M)\$1000 was to be paid on the delivery of the car while the balance was to be paid within one month after such delivery. As Karim was unable to pay the (M)\$1,000, both parties orally agreed that this sum was to be paid in instalments and that meanwhile Lau would lend the car to Karim. After Karim took possession of the car, it was involved in an accident which resulted in injuries to the respondent. Having obtained a judgement against Karim the respondent sought to enforce it against the appellant. The High Court ordered the appellant to pay but the appellant appealed to the Federal Court, contending that they could not be liable as Lau no longer had any insurable interest in the car at the time of the accident. The Federal Court rejected this contention and upheld the decision of the High Court. Evidence relating to the oral agreement was held to be admissible as it was an agreement to modify an existing agreement and therefore came within the proviso to s.90 of the Evidence Act 1950 - a provision on parole evidence.

73. [1967] 1 MLJ 94. For the decision of the High Court see: Salbiah and Anor. v Nanyang Insurance Co. Ltd. [1966] 2 MLJ 16.

According to the Federal Court it was clear from this oral agreement that Lau intended to retain the property in the car until Karim had paid the (M)\$1000.

The court also referred to the provisions of the Sale of Goods (Malay States) Ordinance 1957 in considering when property passes to the buyer in the sale of specific goods. In a contract of sale of specific goods, property is transferred to the buyer at such time as the parties intend it to be transferred⁷⁴. Unless a contrary intention is shown, where there is an unconditional contract for the sale of specific goods in a deliverable state, the property therein passes to the buyer when the contract is made. It is immaterial whether the time of payment or the delivery of the goods is postponed⁷⁵. Unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer and once the property is transferred to the buyer, the goods are at his risk irrespective of whether delivery has been made⁷⁶.

As the risk generally shifts from the seller to the buyer simultaneously with the passing of the property in the goods from the former to the latter, it is also at this

74. s.19(1).

75. s.20.

76. s.26.

time that the seller ceases to have, and the buyer acquires, an insurable interest in the goods. But as this general rule is subject to the intention of the parties, the parties can agree that property in the goods and hence the risk and insurable interest therein be transferred at a time of their choice.

5.2 Insurable Interest in Insurance on Land

As there are no specific local statutes which deals with the law relating to insurable interest in land, by virtue of s.5 of the Civil Law Act 1956, the law applicable in Malaysia is basically the same as that in England.

The indemnity nature of an insurance on land clearly mandates that insurable interest must exist at the time of the loss and that the insured cannot recover except to the extent of his loss⁷⁷. Whether there is a requirement of insurable interest over and above that required by the indemnity nature of such contracts, and whether in particular, the Life Insurance Act 1774 is applicable to insurance on land has yet to be definitively answered⁷⁸. The strongest judicial pronouncement so far which seems

77. Sadler's Co. v Badcock Op. cit. footnote 31.

78. For a consideration of this problem in England and Australia, see Evans, RC, 'The Operation of the Life Insurance Act (UK) 1774 in Relation to the Insurance of Buildings in England and Australia', (1983) 14 Melbourne University Law Review, 262.

to favour the application of the Act is the dictum of Lord Denning in Re King⁷⁹:

[W]hen you take out a policy of fire insurance of a building (as distinct from goods), you must insert in the policy the names of all the persons interested therein, or for whose use or benefit it is made. No person can recover thereon unless he is named therein, and then only to the extent of his interest. That is clear from the Life Insurance Act 1774 (14 Geo. 3 c.48) Ss.2,3 and 4, which by its very terms applies to 'any other event' as well as life.

The fact that the 1774 Act refers to insurance on lives 'and any other event' whilst expressly excluding insurances on ships, goods or merchandises seems to be the strongest argument in favour of the application of the Act to insurance on land.

The argument to the contrary is that the 1774 Act was never intended to apply to such insurance. Being contracts of indemnity, they did not come within the mischief that this Act was seeking to prevent⁸⁰. The application of the Act to such policies is also opposed on practical grounds - that the restrictive nature of the Act makes its application to real property difficult, if

79. [1963] Ch. 459 at p.458. In MacGillivray, this decision is regarded as having resolved the whole problem in the affirmative, see p.65, para.151.

80. Ivamy, EH, Fire and Motor Insurance, 4th Ed., Butterworths, London 1984, p.184.

not impossible⁸¹. In the context of life insurance the 1774 Act has been interpreted as requiring interest at the inception of the policy. If this Act is applied to real property, then the same interpretation must apply⁸². And if, in line with the accepted definition of insurable interest, this interest must be based on a legal right, difficulties will be caused to prudent purchasers who want to protect their interest in the property before they acquire a legal right thereto. In buying property at auction, for instance, a potential purchaser usually obtains insurance cover before the auction, at which time he has no legal right to the property. Under the 1774 Act such a policy is null and void. Even when property is purchased in an ordinary transaction, a prudent purchaser would get insurance cover before the exchange of contract, or in Malaysia, before the registration of his title. Such policies would also be null and void under the 1774 Act for lack of insurable interest at the inception of the policy.

The application of sections 2 and 3 of the 1774 Act may also lead to other unreasonable consequences. S.2

81. Birds, J, Modern Insurance Law, Sweet & Maxwell, London 1982, pp.38-39.

82. MacGillivray, p.13, para.23.

requires the name of the person for whose benefit the policy is made to be inserted in the policy. S.3 provides that no greater sum shall be recovered by the insured from the insurer than the amount of his interest. In insurance on real property it is common for a person to insure the property on his own behalf as well as on behalf of others who are also interested in the property. A landlord for instance may insure not just his interest but his tenants' as well.

In the more recent Court of Appeal decision in Mark Rowlands v Berni Inns Ltd.⁸³, it was said that although s.2 of the 1774 Act referred to 'other events', the Act was not intended to apply, and does not apply, to indemnity insurance⁸⁴.

As the views expressed in the two Court of Appeal cases were obiter, the precise legal position in this respect remains a matter for speculation. The main problem in applying the 1774 Act to real property lies in the fact that even if the insured complies with s.2 and gives the names of all those having an interest in the property, under s.3, on the occurrence of a loss, he can only recover to the extent of his own interest. It has been

83. [1986] 2 QB 211.

84. Ibid. at p.227, per Kerr LJ.

suggested that this problem can be resolved either by regarding s.3 as inapplicable to insurance on land or by construing the word 'insured' therein to include not just the policyholder but also others who are named in accordance with s.2⁸⁵.

Apart from persons with absolute legal ownership over property, the interests of certain others with lesser legal titles are also insurable. This includes the trustees and beneficiaries under a trust⁸⁶ as well as mortgagors and mortgagees⁸⁷ of the property. Where the property is the subject of an agreement to sell, both the vendor and purchaser have an insurable interest therein⁸⁸. The interest of the vendor extends and continues to exist until a formal conveyance has taken place and he ceases to have a legal title over the property. As the risk in the property generally passes to the purchaser on the signing of the agreement unless otherwise agreed, the purchaser has an insurable interest from such date although there has been no formal conveyance of the property⁸⁹.

85. Birds, p.39.

86. Rhind v Wilkinson 127 ER 1068.

87. Smith v Lascelles 100 ER 101 and Samuel & Co. v Dumas [1932] 1 KB 592 at p.615.

88. See further Chapter Ten - Assignment and Trusts.

89. Poole v Adams (1864) 10 LT 287.

CHAPTER FOUR

NON-DISCLOSURE, MISREPRESENTATION AND FRAUD

1.0 Non-Disclosure

1.1 The Duty of Disclosure

1.1.1 Its Origins

Contracts of insurance are contracts uberrimae fidei - of utmost good faith. This special characteristic imposes upon the parties to such a contract a duty of disclosure, ie. a duty to disclose facts which are material to the risk and which are not known by the other party.

The origins of the doctrine of utmost good faith and the duty of disclosure clearly reflect the domination and influence of marine insurance in the development of the general law of insurance in England. In the early days, when a shipowner or a merchant wished to insure a particular ship, cargo or even an entire marine adventure, he would pass around a document known as the 'slip' to the various underwriters at Lloyd's. This 'slip' would contain a brief description of the subject matter for which the cover was sought. All the underwriters who were willing to insure the said risk would then *initial* the 'slip' and write down the

percentages of the risk which they were willing to insure¹.

It was not uncommon that when the 'slip' was being passed around, the subject matter of the insurance would already have started its voyage and would already be in the high seas. In the absence of the sophisticated means of communication which are available to modern day underwriters, it was certainly then beyond the means of the individual underwriters to verify the truth or accuracy of the information given in the 'slip'. The 'slip' was thus the sole yardstick with which the underwriter could assess the risk of a particular adventure and decide whether to provide the cover sought and if so the premium to impose. It was the only means of communication between the proposer and the underwriter prior to the contract. Even so the 'slip' contained few details, unlike the proposal forms of today. Honesty and trust between the parties was thus an absolute imperative for the survival of the industry. This bond of trust and honesty was further nurtured by the fact that both the insurers and the people seeking insurance were a

1. For accounts of the practices at Lloyd's of London, see eg. Vance, WR, A Handbook of Insurance Law, 3rd Ed., Minnesota 1951, at pp.17 - 19, Raynes, HE, A History of British Insurance, 2nd Ed., Pitman, London 1964, at pp.24 - 27 and Hodgson, G, Lloyd's of London; A Reputation at Risk, Penguin, London 1986, at pp.7 - 43.

community, held together by their common interest in maritime adventures. The symbiotic co-existence between them could only continue to flourish provided the utmost good faith continued to be the basis of their dealings with one another.

What started as a rule of practice soon matured into a principle of law, not only in marine insurance but also in non-marine insurance. Judicial acceptance of the practices at Lloyd's as a formal legal principle in non-marine insurance was made by Lord Mansfield in Carter v Boehm:²

Insurance is a contract upon speculation. The special facts upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only; the underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist, and to induce him to estimate the risque as if it does not exist.

Carter v Boehm was not a case in marine insurance. It involved a policy which insured a fort in Sumatra against the risk of being attacked by the enemy.

2. 97 ER 1162 at p.1164. Lord Mansfield himself in this judgement gave no credit to the traditions and practices at Lloyd's. Rather, he regarded the doctrine of utmost good faith as a principle 'applicable to all contracts and dealings'. There is however no evidence of the existence of such a principle either in the cases decided prior to or following Carter v Boehm.

In the early days it was the proposer or the potential insured who was deemed to know the facts relevant to a particular risk. It was he therefore who was expected to disclose these facts to the insurer. The doctrine of utmost good faith as it developed into a principle of law recognises and in fact demands that the utmost good faith be observed by both the insurer and the insured³. Today this reciprocal duty has not only been upheld but an insurer has in fact been made to pay damages to the insured for failing to disclose information in their possession which was material to the risk and not known by the insured⁴.

In spite of the calls and recommendations for reform⁵, the English law on the doctrine of utmost good faith and the duty of disclosure is, with the exception of marine and motor vehicle insurance which have seen some statutory intervention, the sum total of the various judicial interpretations and reinterpretations of the rule as laid down by Lord Mansfield.

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3. The reciprocal duty of utmost good faith was endorsed by Farwell LJ in In re Bradley and Essex and Suffolk Accident Indemnity Society, [1912] 1 KB 415 at p.430. In marine insurance the insurer's reciprocal duty of good faith is provided in s.17 of the Marine Insurance Act 1906 (UK).
 4. Banque Keyser Ullman SA v Skandia (UK) Insurance Co. Ltd. & Ors. [1987] 1 Lloyd's Rep. 69.
 5. The Law Commission, Insurance Law - Non-Disclosure and Breach of Warranty, Cmnd. 8064, HMSO, London 1980.

1.1.2 Time for Disclosure

The duty of disclosure revolves around the fact that all material facts must be made known to the insurer at the time when he makes his decision, first, whether to accept or reject the risk and, second, if he decides to accept the risk, as to the rate of premium to be charged. This duty therefore extends from the time of negotiation until the time when the contract is concluded. This includes the time when the proposal form, if any, is filled in. If the policy is a short-term policy which is subject to renewal, then every renewal is a fresh contract and the duty of disclosure must be complied with prior to every such renewal.

In Lee Bee Soon and Ors. v Malaysia National Insurance Bhd.⁷, the plaintiffs had a Hull Policy dated 29 May 1972 in respect of a motor vessel, with the defendant. The vessel having sank in bad weather, the plaintiff made a claim for (M)\$80,000 under the policy. When the vessel sank it was carrying a cargo of sand and stones. In the proposal form for the said policy, a question was asked as to the type of cargo which would be carried in the vessel. The answer given was 'Passenger - cargo carrying vessel, sundry goods'. The insurer denied liability inter

7. [1980] 2 MLJ 252.

alia on the ground of non-disclosure of material facts. According to the evidence, the vessel carried sand and stones only from 15 September 1972 onwards and the plaintiff contended that he was not bound to disclose this fact as the time for disclosure had ended. Referring to s.21 of the Marine Insurance Act 1906 (UK) on when a contract of marine insurance is deemed to be concluded, Yusoff J said:⁸

In this sense the duty of the assured to disclose all material facts to the insurers must be done before the contract is concluded. Hence if everything material be communicated up to the time of initialling the 'slip' (or proposal) by the underwriter but something material arising between that time and the time of executuing the policy is not disclosed, there is no non-disclosure so as to vitiate the policy...

A rather strange decision in relation to the time for disclosure was reached in The South British Insurance Co. v Haji Ismail⁹. The defendant by a proposal form dated 11 November 1958, was issued with a policy against third party risks in respect of his car. The policy provided cover from 11 November 1958 to 10 November 1959. In answer to a question in the proposal form the defendant stated that he was the registered owner of the car. On 25 September 1959, whilst still registered in the

8. Ibid. at p.253.

9. (1964) 30 MLJ 16.

defendant's name, the car was involved in an accident. The insurer sought to avoid liability inter alia for non-disclosure of a material fact, ie. that the car had been sold to one Wong Fun on 14 November 1958. The learned judge held that there was no need for disclosure as the sale had taken place after the proposal form had been submitted and the contract of insurance entered into.

It is not clear why non-disclosure was relied upon not only by the insurer but also by the learned judge in this case. Unless the sale was regarded as ineffective, and there was no evidence to that effect, clearly the defendant's policy should have lapsed from the date of the sale as thereafter he no longer had any insurable interest in the car. Thus irrespective of the question of non-disclosure, the insurer should not and could not have been made liable under the policy.

1.1.3 Answers in the Proposal Form and the Duty of Disclosure

The duty of disclosure is not synonymous with the obligation to answer the questions in the proposal form correctly. The proposal form is just one of the means by which the disclosure of material facts can be made, so the proposer is not relieved of his duty merely by correctly answering the questions therein. In United Malayan

Insurance Co. v Lee Yoon Heng¹⁰, the insurer sought to avoid a policy on the ground that the exact type of the vehicle which was insured was not disclosed. The insured's contention that he was not required to disclose such information because in the proposal form he was asked only the make of the vehicle, not its type, was rejected by the learned judge.

In Teh Say Cheng v North British and Mercantile Insurance Co. Ltd.¹¹, one of the arguments raised by the insured in denying non-disclosure was that as a person who had never been insured before and was ignorant of insurance law, he was justified in assuming that the insurer required no more information than was sought for by the questions in the proposal form. In response to this argument Whiteley JC said:¹²

In order then, that the plaintiff may derive any benefit from this line of argument, it is necessary for him to establish the proposition that his duty of disclosure is limited to the subject matter of the question. There is an abundance of authority to contradict such a contention...

1.1.4 Effect of Non-Disclosure

Non-disclosure of a material fact makes a contract of insurance voidable at the option of the party to whom the

10. (1964) 30 MLJ 45.

11. (1921) 2 FMSLR 248.

12. Ibid. at p.253.

disclosure ought to have been made. Although there are instances where the insurer initiates proceedings for a declaration that a contract of insurance is void for non-disclosure, there is in fact no legal requirement that the insurer obtains such a declaration first before using non-disclosure as a ground for denying the insured's claim under the policy. In Teh Say Cheng, the insured in denying non-disclosure also argued that even if there had been such a non-disclosure, the proper course for the insurer on discovering it was to take action to rescind the contract and return the premium. To this argument Whiteley JC gave the following response:¹³

No doubt the defendants might have pursued that course. But in so far as it is argued that, because they might have obtained relief by way of rescission, they are precluded from defending the suit generally, the proposition is one which I am unable to accept.

While non-disclosure by the insured enables the insurer to avoid the policy, non-disclosure by the insurer enables the insured to avoid the contract and claim for a return of premium. However as these remedies might not be enough if the loss incurred is great, it has recently been recognised that a party aggrieved by the non-disclosure of material facts by the other party can also sue that party for damages. According to Steyn J in Banque Keyser Ullman SA v Skandia (UK) Insurance Co.

13. Ibid. at p.251.

Ltd. & Ors.:¹⁴

Once it is accepted that the principle of utmost good faith imposes meaningful reciprocal duties, owed by the insured to the insurers and vice versa, it seems anomalous that there should be no claim for damages for breach of those duties in a case where that is the only effective remedy.

1.1.5 Onus of Proof

The legal burden of proving non-disclosure of a material fact rests upon the party alleging the non-disclosure¹⁵. Once this burden has been discharged, the onus then shifts to the other party to rebut it either by showing that there had been a disclosure or that the fact allegedly not disclosed was in fact not material¹⁶.

As to the quantum of proof that is required to rebut an allegation of non-disclosure, the words of Whiteley JC in Teh Say Cheng are instructive:¹⁷

It is beyond dispute, I think, that the burden of proof is on the defendants in the first instance, but to quote from Spencer Bower on 'Actionable Non-Disclosure' p.166, 'Very slight prima facie evidence, indeed, if non-disclosure has already been either admitted or proved is

14. Op. cit. footnote 4 at p.96.

15. Goh Chooi Leong v Public Life Assurance Co. Ltd. (1964) 30 MLJ 5.

16. Pana Vana Letchumanan Chettiar v The Jupiter General Insurance Co. Ltd. (1939) 8 MLJ (Rep) 31.

17. Op. cit. footnote 11 at p.252.

sufficient to cast on the party charged from that point onwards the burden of establishing that the party complaining had acquired knowledge of the undisclosed fact through other channels than a direct communication from the party charged himself'.

1.2 Materiality

1.2.1 Test of Materiality

It is unfortunate in Carter v Boehm that although Lord Mansfield explained in detail the scope and application of the duty of disclosure, his Lordship did not delve into the question of the materiality of the non-disclosed information. This omission was perhaps justified by the fact that in that case the materiality of the non-disclosed information, ie. the weakness of the fort and the likelihood of its being attacked by the enemy, was so obvious that it needed no lengthy consideration. Furthermore it was also held in that case that the facts allegedly not disclosed were either already known to the insurers or could have been discovered by their own efforts.

Cases that were decided in England after Carter v Boehm show that at least two different tests can be used in determining the materiality of a particular fact. The first is that a fact is material if the prudent insurer considers it to be a material fact for the purpose of the insurer making a decision in relation to the risk to be insured. The second is that a fact is material if a

reasonable insured considers it to be material for making such a decision.

The reasonable insured test was applied by the trial judge in Becker v Marshall¹⁸. One of the facts allegedly not disclosed in a proposal for a policy against burglary was the fact that the insured was of foreign origin. To this argument the learned judge responded:¹⁹

I find that he in good faith did not realise that these were things material to be disclosed, and I find that the average businessman, the average reasonable man, would not have taken that view, and ... would have disclosed and would have known that it was necessary to disclose.

On appeal the above test was endorsed by the Court of Appeal²⁰.

The prudent insurer test was applied in Ionides v Pender²¹ where it was said that all should be disclosed which would affect the judgement of a rational insurer governing himself by the principles and calculations on which underwriters do in practice act. This test was endorsed by the Privy Council in Mutual Life Insurance

18. 11 Ll. L Rep. 114.

19. Ibid. at p.118.

20. 12 Ll. L Rep. 413.

21. LR 9 QB 531. See also Zurich General Accident and Liability Insurance Co. Ltd. v Morrison [1942] 2 KB 53.

Co. of New York v Ontario Metal Products Co. Ltd.²²

The lingering doubt as to which of the two tests ought to be applied was settled once and for all by the Court of Appeal decision in Lambert v Co-operative Insurance Society Ltd.²³ which favoured the prudent insurer test. This test has since been consistently applied although there are calls for the re-introduction of the reasonable insured test on the ground that such a test would be less onerous to the consumers²⁴.

In CTI v Oceanus Mutual Underwriting Association Ltd.²⁵, a case in marine insurance, it was held at first instance that the application of this test meant that an insurer could only succeed on a defence of non-disclosure if they could show that a prudent insurer would have declined the risk altogether or would have charged a higher premium if they had known the non-disclosed facts. This however was unanimously rejected by the Court of Appeal. According to the Court of Appeal, to succeed on such a defence it was sufficient if the insurer could show that the underwriting judgement of, or the assessment of risk by,

22. [1925] AC 344.

23. [1975] 2 Lloyd's Rep. 485.

24. The Law Commission Report, Op. cit. footnote 5.

25. [1982] 1 Lloyd's Rep. 178 (1st Instance) and [1984] 1 Lloyd's Rep. 476 (CA).

a prudent insurer would have been influenced by such facts. There was no necessity to show that the final decision reached by such insurer would in fact have been different. Following the Court of Appeal decision in Lambert that in relation to non-disclosure, there is no difference between marine and non-marine insurance, it was held in Highlands Insurance Co. v Continental Insurance Co.²⁶ that the test laid down in CTI was applicable in non-marine insurance as well.

In Malaysia, as in England, the test of materiality in two areas of insurance law are determined by statute. These are in the areas of marine insurance and third party motor insurance. S.18(2) of the Marine Insurance Act 1906 (UK) provides that every circumstance is material which would influence the judgement of a prudent insurer in fixing the premium or in determining whether he will take the risk. In relation to third party motor insurance, s.80(5) of the Road Traffic Ordinance 1958 defines 'material' as 'of such a nature as to influence the judgement of a prudent insurer in determining whether he will take the risk, and if so at what premium and on what conditions'.

In the other areas of insurance law the concept of

26. [1987] 1 Lloyd's Rep. 476.

materiality has not been statutorily defined. The courts in Malaysia however, unlike the English courts, seem to have consistently applied the prudent insurer test even in cases which were decided prior to the Court of Appeal decision in Lambert.

In Teh Say Cheng v North British and Mercantile Insurance Co. Ltd.²⁷, a case involving a fire policy, an attempt was made to persuade the court to reject the prudent insurer test in favour of the reasonable insured test. It was argued that the case of Ionides v Pender whereby the former test was enunciated by Lord Blackburn applied only to cases of marine insurance and that with the exception of the doubtful cases of Trail v Baring²⁸ and Anderson v Commercial Union Insurance Co.²⁹, the said test had not at that time been applied in areas other than marine insurance. This argument was flatly rejected by Whiteley JC:³⁰

The question which I have to consider is not whether it has been applied or not, but whether it ought to be applied. The rule has not only been followed by subsequent cases, it has been incorporated in s.18(2) of the Marine Insurance Act 1906. Is there any good ground for holding that a rule which is obviously proper in marine insurance is too severe to apply in fire insurance? In my opinion there is not. The contract of fire insurance is as much a

27. Op. cit. footnote 11.

28. 46 ER 941.

29. (1885) 55 LJ QB 146.

30. Op. cit. footnote 11 at p.258.

contract of uberrimae fides as is a contract of marine insurance. It follows that the duty to disclose material facts cannot be higher in the one form of insurance than in the other...

The case of Teh Say Cheng thus saw the judicial endorsement of the prudent insurer test in all areas of insurance in Malaysia³¹.

Whiteley JC in endorsing the prudent insurer test in fire insurance could see no reason why a rule which was proper in marine insurance could be too severe when applied in fire insurance. It is submitted that there is indeed an extremely good justification for making such a distinction. Most contracts of marine insurance are entered into either by shipping or other companies or by individuals whose business it is to deal with such policies. These people are all backed with the necessary skill and expertise in this branch of insurance law. On the contrary in most other areas of insurance, one does not take out a policy because it is in the course of one's business to do so. Rather policies are taken out by the man in the street who is not familiar with either the law or the practice of insurance and who wishes to have some form of protection either for himself or for his

31. Although Whiteley JC used the phrase 'rational insurer' in this case, it is submitted that the attributes of such an insurer do not differ from those of the prudent insurer.

family in case of certain eventualities. Thus a test which is not too severe in marine insurance can be and in fact is, too severe when applied in other branches of insurance.

Whiteley JC also reasoned that the duty to disclose could not be higher in one form of insurance than in the other. But if the disparity between the bargaining position of the insured in marine insurance and in non-marine insurance is appreciated, such an argument has no basis. The application of the reasonable insured test in non-marine insurance does not result in the imposition of a lower duty of disclosure. As the insured in marine insurance is either himself an expert in that field or is advised by such an expert, he is certainly in a position to know what facts would or would not affect the decision of the prudent insurer in deciding on a particular risk. As the insured in non-marine insurance is seldom in such a position, he cannot be expected to have the same wisdom and foresight in deciding what facts would or would not affect the decision of the prudent insurer. Hence it is the application of the same test, ie. the prudent insurer test, in both marine and non-marine insurance that will result in the imposition of a higher duty of disclosure upon the insured in non-marine insurance. Only by the application of a different test, ie. the reasonable insured test, in such cases, could an equality in the burden of disclosure between the insured in marine and

non-marine policies be achieved.

The applicability of the prudent insurer test in fire insurance was re-affirmed in Wong Lang Hung v National Employees' Mutual General Insurance³², albeit again in a rather unsatisfactory manner. The plaintiff brought an action to claim (M)\$20,000 under a fire a policy from the defendant. The defendant denied liability, alleging inter alia non-disclosure of a material fact. In the proposal form the plaintiff had written the answer 'No' to a question whether the premises to be insured were attached to other buildings, when the premises were in fact so attached. It was held that there was, by virtue of the answer, a non-disclosure of a material fact and the plaintiff's claim failed.

BTH Lee J in his judgement implied that it did not matter if the insured himself did not appreciate the materiality of the non-disclosed fact, what mattered was whether such a non-disclosure would have influenced the prudent insurer in making his decision³³. This view was however not shared by the Federal Court in Abu Bakar v Oriental Fire and General Insurance Co. Ltd.³⁴ In a proposal form for a fire policy, the appellant was asked, 'For what

32. [1972] 2 MLJ 191.

33. Ibid. at p.195.

34. [1974] 1 MLJ 149.

purposes are the premises occupied?'. The appellant wrote 'Sundry shop downstairs, dwelling first floor'. When a fire broke out on the ground floor of the insured premises, the respondent denied liability on the ground that the appellant had failed to disclose the existence of four electrically operated grinding mills used for commercial purposes, at the back of the shop. Both the Sessions Court and the High Court decided in favour of the insurer. On appeal to the Federal Court, the decision of the lower courts was reversed. The dissenting judgement of Gill FJ focussed mainly on the existence of the basis of contract clause and hence according to his Lordship the question of materiality did not arise.

Ong Hock Sim FJ was of the view that the insurer had not been misled (contrary to the findings of the trial judge) as to the nature of the insurance which the appellant wished to take out and in respect of what goods. According to his Lordship too there was no evidence of the way the presence of the grinding mills could be considered to have increased the risk to the property insured. As this is a case of non-disclosure and not misrepresentation, the question as to whether the insurer had in fact been influenced or in anyway misled is, it is felt, irrelevant. In a case of non-disclosure the question is whether such non-disclosure influences the insurer in deciding whether to accept the risk and if so

the level of premium to be charged. Surely the existence of four electrically operated grinding mills used for commercial purposes is material to a fire policy on the premises.

The most interesting judgement on the question of materiality was that of the Lord President, Azmi LP. Without referring to any local cases on this issue, his Lordship endorsed the prudent insurer test:³⁵

[T]he test hinges on whether the representation is of such nature as to influence the judgement of a prudent insurer, not on whether the representation influences the particular insurer looking at the proposal.

Having stated the test to be applied, his Lordship then proceeded to introduce two qualifications:³⁶

I would further add that if a fact even though material is one which the proposer did not and could not have been expected to know, or if its materiality could not have been apparent to the reasonable man, his failure to disclose should not in my view be regarded as breach of his duty.

The first qualification, that one can only disclose facts which one knows or is expected to know, is not new. After all in the words of Fletcher-Moulton LJ in Joel v Law Union and Crown Insurance Co.:³⁷

35. Ibid. at p.150.

36. Ibid. at p.151.

37. [1908] 2 KB 863 at p.884.

The duty is a duty to disclose and you cannot disclose what you do not know. The obligation to disclose therefore, necessarily depends upon the knowledge you possess.

The second qualification however calls for further consideration. Paraphrased, it reads that even though a fact is material in the eyes of a prudent insurer, it need not be disclosed if the insured himself is not able to appreciate that the prudent insurer will regard such fact as material. This introduces an interesting gloss on the prudent insurer test - not only must a non-disclosed fact be material to the prudent insurer but such materiality must have been obvious or apparent to the reasonable insured. The introduction of this qualification seems to a certain extent to strike a happy median between the prudent insurer and the reasonable insured tests of materiality.

Azmi LP himself cited no authorities in support of the above qualification. The idea of such a qualification however is not a novel one. There are at least two well-known English cases which seem to support such a requirement. A thorough consideration of these two cases however raises doubts as to whether it is an across the board qualification for the prudent insurer test of materiality. The two cases namely, Fowkes v Manchester

and London Assurance Association³⁸ and Joel v Law Union
and Crown Insurance Co.³⁹ are both cases on life
insurance. In Fowkes a person proposing to insure his
life was asked, 'Have you ever been afflicted with
gout?'. He answered 'No'. There was evidence that he had
been treated for a very slight attack of 'supressed
gout.' The surgeon who treated him for this could not
recall whether the insured was informed of this attack.
In directing the jury, Cockburn CJ said:⁴⁰

As to the first answer, to the question whether
he had ever been afflicted with gout, no doubt
it must be considered with some reasonable
latitude, and the answer would not be false,
merely because he had some symptoms which an
experienced medical man might see indicated the
presence of the gout in the system. You will
probably consider whether there was gout in a
sensible, appreciable form, and in considering
that question you will bear in mind that the
medical man himself described the only attack
which preceded the policy, as the slightest
possible case of gout, and that there is no
positive evidence that the deceased knew that
he had gout.

Similarly Joel too involved questions regarding the
medical history of a proposer for life insurance. A
question in the proposal form which asked if the insured
had suffered from mental derangement was answered in the
negative although evidence subsequently revealed that the

38. 176 ER 198.

39. Op. cit. footnote 37.

40. Op. cit. footnote 38 at p.199.

insured had, though she was unaware of the fact, been confined for acute mania.

Fletcher-Moulton J in his judgement explained what was meant by the requirement that the materiality of a particular fact must be appreciated by the insured:⁴¹

Your opinion of the materiality of that knowledge is of no moment. If a reasonable man would have recognised that it was material to disclose the knowledge in question, it is no excuse that you did not recognise it to be so. But the question always is, was the knowledge you possess such that you ought to have disclosed it?

The learned judge then gave the example of a person who, like most people, occasionally had a headache. One of those headaches would have told a brain surgeon of a hidden mischief. But because to the ordinary man that particular headache would not have been distinguishable from the rest, no reasonable man would have considered it material for the insurance company to know. The non-disclosure of that headache would not have been a breach of the duty of disclosure.

Both the cases considered above are cases of life insurance. Both also involved the non-disclosure of particular medical records, the materiality of which the

41. Op. cit. footnote 37.

insured was unable to appreciate due to his lack of medical knowledge. Such a rule is indeed logical in the area of life insurance because the average insured cannot be expected to appreciate the symptoms which are only of significance to persons trained in medicine. To have any other rule is to impose a standard of disclosure which is impossible for the layman to fulfill.

A similar rule may perhaps be reasonably applied in other areas where expert knowledge is required before the materiality of a particular fact can be appreciated, although there has yet to be a case to this effect. A man taking out a policy on his house, for instance, cannot be reasonably expected to appreciate the materiality of and hence to disclose, the existence of a small crack in an inconspicuous corner of the house even though that might have told a qualified surveyor that the surface beneath the house was undergoing serious subsidence.

In Abu Bakar, Azmi LP was of the opinion that the insured could not have appreciated the materiality of information relating to the existence four electrically operated grinding mills which were used for commercial purposes, to a proposal for a fire policy. Even assuming that his Lordship was correct in applying the appreciation of materiality qualification to a non-life policy, it is submitted that in trying to reach a decision in favour of

the insured, his Lordship had grossly under-estimated the intelligence of the insured. Surely no expert knowledge is required for a person to appreciate the fact that the existence of such mills could increase the risk of fire.

Was the introduction of the 'appreciation of materiality' qualification by Azmi LP an innovative new step which was consciously introduced to strike a balance between the interest of the insurer and that of the insured or was it merely the result of a failure to appreciate the fact that in England such a qualification was only limited to life policies? If it is the former, then provided that the insured's foresight and intelligence is not always under-estimated by the courts to the detriment of the insurers, this qualification serves as a useful temporary measure to protect the interest of the insured in this area of the law until such time when the legislature deems it fit to change the test of materiality from one that is based on the prudent insurer to that based on the reasonable insured. The 'appreciation of materiality' requirement can thus pose as a second and perhaps more difficult hurdle for the insurers in their attempt to resort to the doctrine of good faith to deny a claim. For while it may be easy for them to overcome the prudent insurer hurdle by inviting members of their profession to give evidence in favour of the materiality of a particular fact, it may not be as easy for them to adduce evidence to convince the court that the fact of such

materiality was, or should have been, appreciated by the insured.

A second appellate court decision on this issue will clear the air as to the extent of the applicability of this qualification in the test of materiality in Malaysia. As it stands, the case of Abu Bakar seems to represent a bold step forward by the Malaysian judiciary in this area of the law.

1.2.2 Materiality and the Basis of Contract Clause

Most proposal forms contain a 'basis of contract' clause, ie. a declaration signed by the proposer to the effect that that he warrants the truth of the answers therein and that such answers form the basis of the contract between him and the insurer. By virtue of this clause, all answers in the proposal form are accorded the status of warranties, the breach of which would enable the insurer to avoid the contract irrespective of the issue of materiality. On the contrary, if the proposal form does not have such a clause and there is an incorrect answer given in the proposal form, the insurer can only avoid the contract if they can prove that by giving the incorrect answer the proposer has failed to disclose or has misrepresented a material fact. By giving the status of warranties to all the answers in the proposal form, the insurer can avoid a policy by merely pointing to the breach of such a warranty. This saves them the whole

trouble of proving materiality⁴².

The widespread use of the 'basis of contract' clause does not however effectively replace the law relating to disclosure. As mentioned earlier, over and above correctly answering the questions in the proposal form, there remains upon the insured the residual duty of disclosure, ie. a duty to volunteer information which is material to the risk although such information is not solicited by the proposal form. The 'basis of contract' clause has therefore only partially eclipsed the law relating to disclosure. This fact can be clearly appreciated from the Federal Court decision in Abu Bakar. There was a 'basis of contract' clause in the proposal form but both Azmi LP and Ong FJ made no reference to this clause because both were of the view that the questions in the proposal form had been correctly answered. Instead their Lordships proceeded to consider whether in spite of correctly answering those questions, there had been a breach of the residual duty of disclosure. On the contrary, Gill FJ in his dissenting judgement was of the view that the questions in the proposal form had not been correctly answered and so hinged his judgement on the existence of the 'basis of contract' clause.

42. See Chapter Five - Warranties and Conditions.

1.2.3 Evidence of Materiality

In Carter v Boehm evidence was given by an insurance broker to the effect that if the information allegedly not disclosed had been known to the insurers, he did not believe they would have agreed to provide insurance cover. Lord Mansfield was not impressed with this evidence:⁴³

It is mere opinion; which is not evidence. It is opinion after an event. It is opinion without the least foundation from any previous precedent or usage. It is an opinion which, if rightly formed, could only be drawn from the same premises from which the court and jury were to determine the cause; and therefore it is improper and irrelevant in the mouth of a witness.

Despite this strong criticism by Lord Mansfield there has been a marked tendency in the cases after Carter v Boehm for judges not merely to regard as relevant, but often to rely wholly upon, the evidence of persons from within the insurance industry in determining the materiality or otherwise of a particular fact. This change of trend was perhaps necessitated by the application of the prudent insurer test in determining materiality - a post-Carter v Boehm development. Although materiality is a question of law, whether a particular fact is material is a question

43. Op. cit. footnote 2 at p.1168.

of fact. Like all questions of fact, evidence can be adduced to prove the materiality of a particular fact but the ultimate decision rests upon the judge⁴⁴.

When a fact is obviously material, judicial notice should be taken of its materiality. It is only when the court itself cannot form an opinion as to the materiality or otherwise of a fact that evidence should be called for to assist the court in making a decision⁴⁵. The claims history of the insured in relation to the same type of insurance for instance is clearly a material fact. This was obviously not realised by the learned judge and the parties involved in Tan Kang Hua v Safety Insurance Co.⁴⁶ The issue in this case was the materiality of information relating to previous claims made by the insured under a motor policy in a proposal for motor insurance. The insurer called not only its own officer but also an officer of an independent company to give evidence as to the materiality of that fact. The trial judge considered this evidence before deciding that such information was material.

44. In Roselodge v Castle [1966] 2 Lloyd's Rep. 105 for instance, the evidence of a Lloyd's underwriter that the fact that the proposer had long before been caught for stealing apples was material was ridiculed by MacNair J.

45. Per Scrutton LJ in Glicksman v Lancashire and General Assurance Co. [1925] 2 KB 593 at p.609.

46. [1973] 1 MLJ 6.

Where the materiality of a particular fact is less apparent, there seems to be two parallel practices adopted by the Malaysian courts. The first is where the insurer concerned merely calls as witnesses officers of their own company to give evidence as to the materiality of a fact. In Abu Bakar for instance, at the Sessions Court, the insurer's Branch Secretary gave evidence to the effect that if the presence of the grinding mills had been known to them, they would have charged a different premium. This evidence which was not substantiated by any independent witnesses was unconditionally accepted by the Sessions Court, the High Court as well as the Federal Court.

In contrast, judges in England seem to be more wary of the dangers of accepting the particular insurer's evidence as to materiality. In Godfrey v Brittanica Assurance Co. Ltd. Pape J cautioned:⁴⁷

[E]vidence may be given by the defendant as to its practice. But although such evidence is admissible as part of the circumstances existing at the time of the proposal, it does not of itself establish materiality ... it does not of necessity establish that a prudent insurer would have regarded it as material.

47. [1963] 2 Lloyd's Rep. 515 at p.518. See also Bates v Hewitt (1867) LR 2 QB 595 and Zurich General Accident v Morrison [1942] 2 KB 53.

An approach similar to that taken by the Malaysian courts in Abu Bakar was however taken by the Supreme Court of Canada in Henwood v Prudential Insurance Co.⁴⁸ where the court, relying largely on the uncontradicted evidence of the insurer's own medical and underwriting experts given during the trial, held that information relating to visits to a psychiatrist for treatment of a nervous disorder was material for a life policy.

It is exceptionally easy for an insurer to have one of its own officers to give evidence as to the materiality of a particular fact. The materiality of a particular fact must be looked at from the eyes of the prudent insurer and not from the eyes of an insurer who has an interest in a particular case. Accepting the unsubstantiated evidence of an interested insurer makes a mockery of the prudent insurer test. It can also cause extreme hardship to individual litigants who, though aware of the fact that there may be opinions to the contrary in the insurance circle, will seldom have the means to get an independent witness to give evidence. Since the onus of proving materiality rests upon the insurer, it should be the insurer who should adduce independent evidence to support a claim that a particular fact is material in the eyes of the prudent insurer. If

48. (1967) 64 DLR (2d) 715.

the insurer merely puts its own officers on the witness stand, it is also the duty of the insured's counsel to object to the admissibility of such evidence⁴⁹.

The second practice which seems to be more in line with that followed in England is that of calling both the insurer concerned as well as independent insurers to give evidence as to materiality. This approach not only seems more fair but also seems to be a more effective and realistic way of applying the prudent insurer test. This approach was followed in Teh Say Cheng v North British and Mercantile Insurance Co.⁵⁰ where the fact allegedly not disclosed was that the insured had an unsatisfied judgement against him at the time he made the proposal for insurance. In deciding on the materiality of this fact, the learned judge heard the evidence from the insurer concerned as well as that of two independent insurers.

If the fact allegedly not disclosed is something new to the insurance industry as a whole, even disinterested parties can only give their opinion as to whether or not that fact is material. In the old case of Tan Tye v

49. In Horne v Poland [1922] 2 KB 364 at p.365, the learned judge expressed doubt as to whether evidence given by the insurer's witness was admissible but accepted it because it was not objected to by the other party.

50. Op. cit. footnote 11.

Union Insurance Society of Canton⁵¹, timber which was being shipped in a vessel was insured by its owners. It was alleged by the insurer that the insured had failed to disclose that the value of the timber had been inflated because the profit expected from the sale of the timber had been over-valued. The four independent witnesses who were called gave different opinions as to the percentage of profits that could be regarded as excessive and therefore would have to be disclosed. The learned judge in this case reiterated that having heard the different opinions, the ultimate decision regarding materiality rested solely with him.

1.2.4 Material Facts - Physical Hazards

As the materiality or otherwise of a particular piece of information is a question of fact, something which is regarded as material in one case cannot, ipso facto be regarded as material in all subsequent cases. The materiality of a particular fact has to be determined within the context of the case itself. Case-decisions on the materiality of a particular fact can therefore be regarded only as guidelines in subsequent cases.

Facts regarded as material have traditionally been classified into two broad categories, facts relating to

51. (1879) 1 Ky. 482.

physical hazards and facts relating to moral hazards. The distinction between the two was explained by Whiteley JC in Teh Say Cheng:⁵²

Moral hazard is chiefly a man's standing and general reputation. The word hazard I use as equivalent to the risk of fire. The physical hazard is determined by the physical condition of the building and the nature of the stock...

The common denominator in both physical and moral hazards is that both can influence the insurer's decision whether to accept the risk and, if so, the premium to be charged. The presence of either of these hazards increases the chances of a claim being made under the policy. When the risk of claim is increased because of the physical nature of the subject matter of the insurance such as the storage of excessive fuel in a building insured under a fire policy or that the life insured under a life policy is suffering from cancer, these are physical hazards which are material to the respective policies. Moral hazard relates to the risk of a claim being made not by virtue of the physical nature of the subject matter of the insurance but by virtue of the insured's own general reputation and credibility. The fact that a proposer for a fire policy has been convicted for fraud for instance is a moral hazard.

52. Op. cit. footnote 11 at pp.259 - 260.

Considered below are some of the physical hazards recognised so far in the different branches of insurance in Malaysia.

(i) Fire Insurance

In fire insurance the physical hazards are those that have a tendency to increase the risk of fire. In Wong Lang Hung v National Employees' Mutual General Insurance Association Ltd⁵³, it was held that the fact that the insured building was attached to another building was material. Similarly in a fire policy on stocks of rubber, it was held in Asia Insurance Co. Ltd. v American International Assurance Co.⁵⁴ that the place where the rubber was to be stored was material. Interestingly however the Federal Court in the case of Abu Bakar v Oriental Fire and General Insurance Co.⁵⁵ did not consider the presence of four electrically operated grinding mills in the insured premises to be material to a policy insuring the said premise against fire. According to Ong Hock Sim FJ such fact was not material because it did not change the character of the insured premises. With respect, the test used is erroneous. If the presence of such mills increases the risk of fire, surely it should not matter whether the character of the

53. [1972] 2 MLJ 191.

54. (1953) 19 MLJ 87.

55. Op. cit. footnote 34.

premises was changed or not.

(ii) Motor Insurance

In motor insurance, the purpose for which the vehicle is to be used is a material fact, as is the type and make of the vehicle. In United Malayan Insurance Co. v Lee Yoon Heng⁵⁶, in a proposal for motor insurance the insured stated that the vehicle was to be used for private purposes. The insured worked as an advertiser and the vehicle was in fact used for carrying equipment for advertising, to the villages. It was held that the purpose for which the vehicle was to be used was material and ought to have been disclosed. According to Gill J:⁵⁷

[I]f the vehicle was to be used for commercial purposes [the insurer] would have issued not a private car policy but a commercial vehicle policy, in which the premium charged, the other conditions and limitations as to use would be different.

(iii) Life Insurance

In life insurance all information that tends to show that the insured may die earlier than expected is material. Any major ailments suffered by the insured is therefore material. In Goh Chooi Leong v Public Life Assurance Co. Ltd.⁵⁸ for instance, it was held that the fact that the

56. (1964) 30 MLJ 453.

57. Ibid. at p.455.

58. (1964) 30 MLJ 5.

insured had suffered from pulmonary tuberculosis was material.

While information relating to the age of the life insured is certainly a material fact as this directly influences the insurers's decision either in accepting the risk or in determining the premium⁵⁹, the law in this respect in Malaysia has been modified by s.15C of the Insurance Act 1963 which provides that no life policy shall be called in question by reason only of a misstatement of the age of the life insured⁶⁰. The Act instead provides a formula for adjusting the premium once the true age is known. A Malaysian insurer can therefore no longer seek to avoid a life policy on the grounds of non-disclosure of the correct age of the life insured. Evidence as to the materiality of such information is also of no relevance.

(iv) Employer's Liability Insurance

In an employer's liability policy, the number of employees employed is material. In Fook Yew Timber Co. v The Public Insurance Co. Ltd.⁶¹, the plaintiff had an employer's liability policy issued by the defendant. For the first policy which was for a period of three months,

59. Hemmings v Sceptre Life Association Ltd. [1905] 1 Ch. 365.

60. See infra. pp.186 - 188.

61. (1960) 26 MLJ 72.

the plaintiff gave the number of their employees as six. As no new information was given upon renewal of the policy, the renewal was also made on the basis that there were six employees. The plaintiff in fact had in their employment between twenty to thirty labourers. It was held that the insurer was not liable under the policy as there had been a non-disclosure of a material fact, ie. the correct number of employees in the plaintiff's employment.

(v) Marine Insurance

In an insurance on a vessel, the fact that the vessel had previously been grounded is a material fact⁶². The type of cargo to be carried by a vessel is also material but if the change of plans to carry one type of cargo to another took place after the issue of the policy, such change in plans need not be disclosed⁶³.

In a marine policy on goods, the fact that the goods are to be carried on the deck of the ship is material⁶⁴. When the goods are insured not on their actual value but together with an excessive valuation of the profits

62. Mazzarol v United Oriental Assurance Sdn. Bhd. [1983] 1 MLJ 328.

63. Lee Bee Soon and Ors. v Malaysia National Insurance Sdn. Bhd. Op. cit. footnote 7.

64. Pana Vana Letchumanan Chettiar v The Jupiter General Insurance Co. Ltd. Op. cit. footnote 16.

expected, this fact too is material⁶⁵.

1.2.4 Material Facts - Moral Hazards

Information relating to the general standing, reputation and financial credibility of the insured and of others in any way connected with the policy are material and ought to be disclosed. These facts are commonly described as moral hazards. The reason why such information is regarded as material is obvious; it is generally regarded that the risk involved in issuing a policy to a person with such moral hazards, such as a person who is financially unsound or who has been convicted of offences involving dishonesty, is far higher than the risk involved in issuing a similar policy to someone with a clean record.

Although the validity of this line of reasoning has been challenged, moral hazards continue to be regarded as a category of material facts. The test of what in fact amounts to a moral hazard, though, changes not only according to the facts and circumstances of the case but also according to the general norms of a particular society at a given time. In Malaysia, the following are some of the moral hazards that have been regarded as material.

65. Tan Tye and Anor. v Union Insurance Society of Canton
Op. cit. footnote 51.

(i) Financial Standing

Although a person's excessive wealth may not be a material fact, his adverse financial standing at the time he makes a proposal for insurance is. This includes the fact that there is an unsatisfied judgement against him and that his property has been attached in the execution of such a judgement. In Teh Say Cheng v North British and Mercantile Insurance Co.⁶⁶, one of the reasons given by the insurer in denying liability under a fire policy was that the insured had failed to disclose that he had an unsatis~~x~~fied judgement against him and that his stock-in-trade had been attached in execution. The insured's counsel argued that such factors were extraneous to the risk and could not therefore be regarded as material. This was rejected by the learned judge who reasoned⁶⁷:

Was the [insured's] financial position at the time when he was negotiating with the [insurer] such as would have affected the judgement of a rational insurer, governing himself by the principles on which insurers do in practice act, in considering whether he would accept or decline the proposal? ... it seems to me beyond doubt that the [insured's] financial position ... was such as would have affected the judgement of any rational insurer in considering whether he would accept or decline the proposal.

As the above case involves a fire policy, it may be safe

66. Op. cit. footnote 11.

67. Op. cit. footnote 11 at pp.259 - 260.

to presume that in a proposal for fire insurance the insured's adverse financial standing is material. Whether the same is true in relation to other branches of insurance remains to be seen. It is however noteworthy that none of the three witnesses who gave evidence relating to the materiality of the insured's adverse financial standing in the above case linked the materiality of such fact to the type of insurance in question. Instead they all seemed to have regarded a person's adverse financial standing as a moral hazard per se, irrespective of the type of insurance applied for. As the witnesses were all from within the insurance industry, it is extremely foreseeable that should a similar question arise in another branch of insurance, the insurer would be able to adduce similar evidence in favour of the materiality of such information to the type of insurance involved.

(ii) Insurance History

The phrase 'insurance history' is here used in its widest possible context. It includes claims which have been made, refusals by an insurer to issue or renew a policy, cancellation of policies or the the imposition of a higher rate of premium.

There are two aspects of insurance history, the insurance history of the insured in relation to the type of insurance he is seeking, for instance in seeking for a

life policy, particulars in relation to other previous or existing life policies; and the insurance history of the insured in all areas of insurance, not just for the type for which he is seeking cover.

In Malaysia there is a difficulty in establishing a pattern regarding the materiality of the insured's insurance history. This is because matters relating to the insured's insurance history are normally made the subject of specific questions in the proposal forms. As the proposal forms almost always contain a 'basis of contract' clause, any untrue answers are deemed to be a breach of warranty and the question of materiality becomes irrelevant. In Ong Eng Chai v China Insurance Co. Ltd.⁶⁸ for instance, in a proposal for motor insurance the insured was asked if he had had his policy cancelled or refused a renewal. There was such a clause in the proposal form. The learned judge cast aside all questions of materiality because:⁶⁹

It is settled law that when in a proposal to effect an insurance the parties agree that something should be the basis of contract, it would not be open to the court to consider the question of materiality.

A similar decision was reached in National Insurance Co.

68. [1974] 1 MLJ 82.

69. Ibid. at p.83.

Ltd. v Joseph⁷⁰.

Perhaps the only reported Malaysian case involving the alleged non-disclosure of the insured's insurance history which was decided solely on the question of materiality is Tan Kang Hua v Safety Insurance Co. Ltd.⁷¹, a decision of the Federal Court. At the High Court the insurer had successfully obtained a declaration that a policy issued by them to the insured was void as it was obtained by misrepresentation and non-disclosure of material facts. In the proposal form, the insured was asked if he had ever made a claim under any motor policy. The answer 'Nil' was given. In answer to another question the insured stated that he was entitled to a 'No Claims Bonus' from his previous insurer and that he had been insured free from claims for two consecutive years. The insurer alleged that the insured had failed to disclose the fact that he had, within the last two years made a claim from his previous insurer. The High Court held that this information was material and declared the policy void.

On appeal, the Federal Court⁷² agreed with the decision

70. [1973] 2 MLJ 195.

71. [1973] 1 MLJ 6.

72. Interestingly no reference was made by either of the courts to any 'basis of contract' clause. It is unlikely that the proposal form in question did not have such a clause. If there was such a clause it was extremely negligent of the insurer's lawyers not to have relied upon it in denying liability.

of the High Court as to the materiality of the said information. The Federal Court however reversed the decision of the High Court on the ground that although the information not disclosed was material, it was information which was already known to the insurer and the insured was therefore under no duty to disclose it.

Whilst it is clear from the above case that the insured's insurance history in relation to the same type of insurance is material, it remains to be decided whether his insurance history in relation to one type of insurance is material to his application for another type of insurance. In England, according to the Court of Appeal in Locker & Woolf Ltd. v Western Australian Insurance Co.⁷³, an insured must disclose the fact that his proposal for a fire policy has been rejected in an application for a motor policy. This decision however need not necessarily have laid down the general rule in this respect. After all different pieces of such information may or may not be material depending on the circumstances of the case. While it may be difficult for even the shrewdest of insurers to prove the materiality of an isolated claim in a different type of policy made long before the proposal for the current policy, there can be situations where the proposer's insurance history

73. [1936] 1 KB 406.

in another type of insurance may bring out other negative aspects of the insurer's character, perhaps a tendency to exaggerate or even to falsify claims.

(iii) Criminal and Statutory Offences

While in England the materiality or otherwise of the proposer's criminal history has been subjected to countless judicial pronouncements, there has only been one such reported case in Malaysia. The lack of local decisions however did not seem to have affected the learned judge's creativity in New India Assurance Co. v Pang Piang Chong⁷⁴. In a proposal for a motor policy the proposer was asked whether he, or any other person who would to his knowledge drive the car, had been convicted for offences in connection with the driving of any motor vehicle during the preceding five years. The answer given was 'No'. The vehicle was involved in an accident whilst driven by another person with the insured's permission, resulting in the death of a third party. The insurer sought a declaration that the policy was void for non-disclosure of material fact as the insured had failed to disclose that during the five years preceding the policy he had been convicted of five offences under the Road Traffic Ordinance. Three of these offences were for using vehicles without the required licences,

74. [1971] 2 MLJ 34.

one for not having a third party insurance and another for not displaying an L-plate on a vehicle. It was held that there was no non-disclosure as these offences did not show that the insured was irresponsible for the purposes of an insurance cover nor did they make him a bad risk. According to Syed Othman J:⁷⁵

The purpose of an insurance in this case is to cover the insured in the event of an accident. The primary concern of an insurer before he insures a proposed insured is therefore to determine whether he is a bad risk. I do not think that it should be the concern of the prudent insurer as to whether or not the proposed insured has committed an offence for non-compliance of statutory requirements which are not pertinent to show that he is a bad risk ... the real test ... is whether the proposed insured is a bad risk. I am unable to see that by the conviction for the five offences the [insured] is a bad risk.

In support of his decision the learned judge cited three⁷⁶ English cases namely, Revell v London General and Insurance Co. Ltd.⁷⁷, Taylor v Eagle Star⁷⁸ and Cocos v De Rougemont⁷⁹.

In holding that only convictions for offences which were

75. Ibid. at p.36.

76. The learned judge however admitted that he did not read the original reports of the last two cases.

77. [1934] All ER Rep. 744.

78. (1940) 67 Ll. LR 136.

79. (1925) 23 Ll. LR 34.

related to the careful and skillful manner of driving were material, the learned judge seemed to have relied in particular upon the decision in Revell. However, although one of the convictions not disclosed in Revell was similar to that in Pang Piang Chong, ie. for driving without there being in force a policy of insurance, Revell should not, it is submitted, have been used as authority for holding such information to be immaterial. The decision in Revell centred on the existence of a 'basis of contract' clause; the issue there being not one of materiality but whether a question in the proposal form had, on reasonable construction, been correctly answered. The answer 'No' was given to the question 'Have you or any of your drivers ever been convicted of any offence in connection with the driving of any motor vehicle?'. It was held that as a reasonable person reading the question might honestly have considered that a conviction for driving without a policy of insurance and for other similar offences were not offences in connection with the driving of a car, the question had been correctly answered. As this case dealt solely with the interpretation of questions and answers in the the proposal form and the effect of the 'basis clause', the issue of the materiality of those convictions were never considered. On the contrary, in Pang Piang Chong the issue was whether the residual duty of disclosure had been breached. The insurer in seeking to avoid this policy specifically stated that this was because 'apart

from any provisions contained in the policy, the policy was obtained by non-disclosure of material facts'.

In Taylor v Eagle Star, a question in the proposal form read: 'Have you or your driver been convicted with any offence in connection with the driving of any motor vehicle?'. The answer 'No' was given although the proposer had been convicted of certain drinking offences and the offences of permitting a car to be used without a policy of insurance and of driving a car without a road fund licence in force. It was held that although the answer given was not untrue based on the decision in Revell, there remained upon the proposer, apart from the obligation to answer questions in the proposal form truthfully, the residual duty to disclose all material facts. As information relating to the offences were material, it was held that the insured had been in breach of this residual duty in not disclosing them⁸⁰.

Thus when a proposal form contains a 'basis of contract' clause and an answer given in the proposal form is allegedly incorrect, no question of materiality arises. All that has to be decided is whether on reasonable construction, the question has been correctly answered.

80. See supra. pp.131 - 132.

However, even if the questions in the proposal form had been correctly answered, it remains to be considered whether the proposal form aside, the proposer has failed to disclose some other material facts and it is at this stage that the question of materiality arises.

The learned judge in Pang Piang Chong also stated that to be material, the previous convictions must have shown that the insured was a 'bad risk' for the purpose of insurance. According to him the five offences for which the insured had been convicted did not make him a 'bad risk' and therefore need not have been disclosed. It is submitted that the scope of moral hazard is far wider than being a 'bad risk'. It covers the whole question of the moral integrity of the insured and certainly includes a person's tendency to commit offences, albeit only statutory offences. This clearly represents the English law⁸¹ as is illustrated by Locker and Wolf Ltd. v

81. A more restrictive test was applied in the Canadian case of Alliance Insurance Co. v Laurentian Colonies and Hotels Ltd. [1953] Que. QB 241 where it was held that the fact that the director of a company had been convicted for living off the proceeds of prostitution was not material to an application for a fire policy because such conviction would not increase the risk of loss by fire. This decision however was not based on the common law concept of materiality but on the interpretation of Art. 2485 of the Canadian Civil Code which reads: 'The insured is obliged to represent to the insurer fully and fairly every fact which shows the nature and extent of the risk, and which may prevent the undertaking of it or affect the rate of premium.'

Western Australian Insurance Co.⁸² where it was held that previous convictions would be material if they tended to show that the person concerned was an undesirable person with whom to have contractual relations.

As there are no cases to that effect, it remains to be seen how a Malaysian court would treat the non-disclosure of offences which are totally unrelated to the subject matter of insurance, such as a conviction for gambling in a proposal for a fire policy. Perhaps in such a situation the individual convictions would have to be looked at. If they show general dishonesty or other criminal tendencies then such convictions should be regarded as material.

A factor to be noted in relation to the disclosure of criminal convictions is that, unlike England⁸³, Malaysia does not have a Rehabilitation of Offenders Act. A convicted criminal in Malaysia will never get a 'clean slate'. In this light perhaps a more restrictive test to the materiality of such convictions makes sense. While in England there are two sifting processes which have to be undergone before a criminal conviction is required to be disclosed, ie. first the Rehabilitation of Offenders Act and second the test of materiality, in Malaysia there is

82. Op. cit. footnote 73.

83. Rehabilitation of Offenders Act 1974, c.53.

only one such process in the form of the latter. It is therefore desirable that such a process be rigid enough to ensure the disclosure of relevant criminal convictions only.

1.2.6 Facts Which Need Not be Disclosed

The very basis of the duty of disclosure is that by their very nature there are certain facts which are within the exclusive knowledge of one of the contracting parties only. It is in relation to such facts that a duty is imposed upon that party to disclose such facts which are material to the risk to the other party. Matters which are not within the exclusive knowledge of either of the parties are therefore not subject to the duty of disclosure. This includes not merely facts which are known to both parties but also those which both have a means of finding out. Carter v Boehm is a clear illustration of this rule as it was held in that case that the insured had not been in breach of the duty of disclosure because the insurer had the means and could have found out about the facts allegedly not disclosed by the insured. This case imposes a positive duty upon the insurer to find out the material facts and as long as they have the means of doing so the insured is not in breach of such duty.

Cases after Carter v Boehm, unfortunately ignored this positive duty placed upon the insurers and soon

transformed the rule into what it is today - that a material fact need not be disclosed only if the insurer has actual knowledge about it. This is particularly so in Malaysia⁸⁴.

Before it can be said that an insurer knows about a particular fact and therefore no disclosure is required, such knowledge must be based on concrete facts. If the insurer merely heard rumours about such fact this is not sufficient to relieve the insured of the duty of disclosure. In Teh Say Cheng v North British and Mercantile Insurance Co.⁸⁵, an employee of the insurer stated in evidence that he had heard rumours that the insured had an unsatisfied judgement against him - the information which was allegedly not disclosed by the insured. It was held that this knowledge was insufficient to discharge the insured of his duty of disclosure.

The non-disclosure of a material fact cannot be used by the insurer to avoid a policy if there are evidence that the insurer has waived the disclosure of such information. While the proposer does not exhaustively discharge his duty of disclosure by merely correctly

84. See eg. Tan Kang Hua v Safety Insurance Co. [1973] 1 MLJ 6, Asia Insurance Co. Ltd. v American International Assurance Co. Ltd. Op. cit. footnote 54 and Fook Yew Timber Co. v the Public Insurance Co. Ltd. (1960) 26 MLJ 72.

85. Op. cit. footnote 11.

answering the questions in the proposal form, there can however be situations where by the nature of the questions in the proposal form the insurer can be deemed to have waived the disclosure of certain other information. When an insured is asked a question with reference to a specific time frame, it is generally accepted that the insurer has waived the disclosure of similar information which falls outside such a time frame.

An interesting case of waiver arising out of the nature of the questions in the proposal form can be seen in Mazzarol v United Oriental Assurance Sdn. Bhd.⁸⁶. A claim by the insured whose vessel had grounded was denied by the insurer on the ground that he had failed to disclose the fact that the vessel had grounded before. In the proposal form under the heading 'General' the insured was asked inter alia, 'Do you own any other vessel?', The insured answered 'No'. 'Give details of accidents that occurred in the last four years to these vessels.' Answer 'No'. 'Any of these accidents relate to the vessel proposed for insurance?' Answer 'N/A' meaning not applicable. The insurer alleged that the fact that the insured vessel had grounded before ought to have been disclosed in answer to the last two questions. This

86. Op. cit. footnote 62.

contention was rejected by George J:⁸⁷

The questions under 'General' specifically avoid accidents to the vessel proposed for insurance other than accidents to it involving other vessels owned by the proposer. No place is provided in the proposal form for information of previous accidents to the vessel ...

On the basis of the format of the defendant's proposal form ... I conclude that there was neither misrepresentation made to the company or concealment of material facts ... and I hold that there was no non-disclosure that entitles the defendants to avoid the policy.

Apart from waiver of disclosure by the nature and format of the questions in the proposal form, there can also be waiver of disclosure by the conduct of the officers of the insurance company concerned. The possibility of such a waiver by conduct was considered by Whiteley JC in his judgement in Teh Say Cheng⁸⁸ but no examples of conduct which could amount to waiver were given. Perhaps a waiver by conduct can occur in a situation where the subject matter of the insurance has been subjected to a visual examination by the insurer. If such an examination would have disclosed something in relation to which further enquiries ought to have been made but no such enquiries were in fact made, then that should amount to waiver of any information which such an enquiry would have revealed.

87. Op. cit. footnote 62 at p.331.

88. Op. cit. footnote 11 at p.255.

2.0 Misrepresentation

2.1 Its Applicability in Insurance Law

Insurers in seeking to avoid a policy frequently rely upon both non-disclosure as well as misrepresentation. This coupled with the almost inevitable presence of the notorious 'basis clause' in most policies, has resulted in the blurring of the line of distinction between non-disclosure and misrepresentation in insurance contracts. Sometimes this distinction is not even appreciated by the courts and frequently the two are used interchangeably⁸⁹. The tendency to do so no doubt originated from England⁹⁰. However there now seems to be change of trend in England; a phenomena which has yet to be seen in Malaysia. In Kumar v Life Insurance Corporation of India⁹¹ the insured answered the following questions in the proposal form in the negative:

Q.4(d) Have you consulted a medical practitioner within the last five years? If so give details.

Q.8(a) Did you ever have any operation, 'accident or

89. See eg. United Malayan Insurance Co. v Lee Yoon Heng Op. cit. footnote 10 at p.454 where the learned judge referred to the 'material misrepresentation or non-disclosure' in the proposal form.

90. Eg. London Assurance Co. v Mansel (1879) 11 Ch. D 363 and Godfrey v Brittanian Assurance Co. [1963] 2 Lloyd's Rep. 515.

91. [1974] 1 Lloyd's Rep. 147.

injury? If so give details.

The learned judge in this case took the unprecedented approach of deciding the case solely on the basis of misrepresentation. He therefore regarded as irrelevant arguments as to whether the non-disclosed information, ie. the fact that the insured had undergone a Ceasarian section, was material or whether the knowledge of the said information could be imputed to the insurer.

It is hoped that this innovative⁹² approach will not go unnoticed in Malaysia particularly as the law relating to misrepresentation is rather complete in Malaysia.

2.2 Sections 18 and 19 of the Contracts Act 1950

Misrepresentation according to s.18 of the Contracts Act includes:

- (a) the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;
- (b) any breach of duty which, without an intent to deceive, gives an advantage to the person committing it, or anyone claiming under him, by misleading another to his prejudice, or to the prejudice of anyone claiming under him;
- (c) causing, however innocently, a party to an

92. For a favourable opinion on this approach, see Hasson, RA, 'Misrepresentation and Non-Disclosure in Life Insurance - Some Steps Forward', [1975] MLR 89.

agreement to make a mistake as to the substance of the thing which is the subject matter of the contract.

Where there is misrepresentation, a contract is voidable at the option of the aggrieved party unless the aggrieved party had the means of discovering the truth with ordinary diligence. Similarly if the misrepresentation did not cause the consent of the party to whom the misrepresentation was made, the contract is not voidable⁹³.

Cases of non-fraudulent misrepresentation in contracts of insurance should, it is submitted, be considered in the light of these provisions. An insurer should only be able to avoid a policy for innocent misrepresentation provided they had no means of finding out the truth with due diligence and provided the misrepresentation had caused them to consent to the contract. A heavier burden is placed upon the insurer by these provisions compared with the duty of disclosure.

The scope of misrepresentation under the Contracts Act being far narrower than the common law duty of disclosure, it is hoped that the example set in Kumar

93. s.19.

will be followed in Malaysia and that judges will refrain from deciding cases of misrepresentation on the basis of non-disclosure.

3.0 Fraud

3.1 Its Applicability in Insurance Law

The extensive scope of the duty of disclosure coupled with the continued recognition of the 'basis of contract' clauses, has often made it unnecessary for an insurer to rely upon fraud in avoiding a policy. There is also a general reluctance to rely upon an allegation of fraud because the requirements for proof of fraud as laid down in Derry v Peek⁹⁴ are far more stringent than the requirements for proof of non-disclosure. To substantiate an allegation of fraud, it must be shown that a representation is made knowingly either without belief in its truth or recklessly without caring whether it is true or false.

In the context of insurance law, in order to allege fraud, there must first be a representation; a mere omission to disclose does not amount to such a representation. Even where there is such a representation

94. (1889) 14 App. Cas. 337 (HL).

it is much easier for the insurer to allege either breach of warranty or non-disclosure because in doing so the insurer is not required to adduce evidence as to the insured's state of mind. In alleging fraud, the insurer must either show knowledge or at least recklessness on the part of the insured. Both these elements are not easy to prove.

3.2 Section 17 of the Contracts Act 1950

In Malaysia, the law in relation to fraud like that in relation to misrepresentation is found in the Contracts Act 1950. According to s.17, fraud includes the active concealment of a fact by a party to a contract having the knowledge or belief of the fact, with intent to deceive another party or to induce him to enter into the contract. The explanation to this section states that mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silent to speak, or unless his silence is, in itself equivalent to speech.

From the above it is clear that in certain circumstances silence or an omission to disclose can amount to fraud. As in a contract of insurance the duty of utmost good

faith demands that facts material to the risk be disclosed, it is in fact a contract where there is a 'duty to speak'. Failure to disclose a fact which is material to the risk can therefore amount to a fraud.

While the provisions relating to fraud in s.17 can in certain circumstances be used in place of non-disclosure, s.17 does not and cannot completely and effectively replace the law relating to non-disclosure. There are two reasons for this. First, a basic ingredient of fraud under s.17 is an intention to induce or to deceive the other party into entering the contract. This automatically excludes from its scope cases of negligent non-disclosure which forms the bulk of non-disclosure cases. Second, s.19 of the Contracts Act provides that when consent to an agreement is caused by silence amounting to fraud under s.17, the contract is voidable at the option of the aggrieved party. But if the silence did not cause the consent of the other party or did not induce the other party to enter into the contract, then the contract is not voidable. This is an extremely difficult element to prove and as such it may be far easier to rely on non-disclosure by proving materiality.

Although s.17 can be used in certain cases of

non-disclosure, this has yet to happen in Malaysia⁹⁵. The insurer cannot be expected to be over eager to use s.17 in place of non-disclosure given the difficulties mentioned above. There is however one possible advantage for the insurer if fraud is relied upon. Section 76 of the Contracts Act allows the aggrieved party to claim for damages when a contract is avoided for fraud or misrepresentation⁹⁶.

4.0 Indisputability Clauses in Life Policies

The general reluctance of the Malaysian judiciary to stray from the established common law principles is not shared by the legislature. An attempt has been made by the latter to restrict, albeit in a very limited sense, the scope and application of the duty of disclosure in life insurance. The Amendments of 1975 and 1978 to the Insurance Act introduced the concept of indisputability clauses in life insurance. Section 15C provides that such a policy shall not be called in question by reason only

95. A similar provision in the Indian Contracts Act 1872 was however applied by the Indian Supreme Court in Mithoolal Nayak v Life Insurance Corporation of India AIR 1962 SC 814. The insured in applying for a life policy had not only failed to disclose several serious ailments but had also made false statements to the effect that he has never been treated for such ailments. The Supreme Court held that this was fraud under s.17 of the said Act.

96. But damages are now also awarded for non-disclosure, see Banque Keyser Ullman SA v Skandia (UK) Insurance Co. Op. cit. footnote 4. See also supra. pp. 133-134.

of a misstatement of the age of the life insured. Instead a method is provided by which adjustments could be made by the insurer to the insured sum on the discovery of the correct age. This provision has effectively negated the effects^{of} non-disclosure, breach of warranty and misrepresentation in relation to misstatements as to age in life policies. It is an extremely useful provision in the Malaysian context because many people who were born during the pre-independence days, do not have proper documents relating to their birth. It is however unfortunate that this provision applies only to life policies. While it is a fact that the age of the insured is more important in life than in other policies, age can also be a material fact in other types of policies like motor vehicle policies. If individuals are excused for misstating their age in an application for a life policy, why should they not be excused for the same omission in respect of other types of policies? s.15C(1) can play an even more significant role in protecting the interest of the insured if it is made applicable to non-life policies as well.

Another even more significant defect of s.15C(1) is that no exception is made for fraudulent misstatement of age. In Anctil v Manufacturer's Life Insurance Co.⁹⁷, it was

97. [1899] AC 604 (PC).

held that if a policy is expressed to be indisputable, it does not prevent a party from raising fraud even if there is no express exception for fraud in the policy. Presumably the same principle ought to be applied to a statutory indisputability clause like s.15C(1) otherwise it is grossly unfair to the insurers if they are prevented by virtue of this provision, from raising an allegation of fraud as regards the insured's age.

Apart from the indisputability clause as to age, there is also another more general indisputability clause for life policies. This is s.15C(4) which reads:

No life policy ... shall after the expiry of two years from the date on which it was effected be called in question by an insurer on the ground that a statement made in the proposal for insurance or in a report of a doctor, referee, or any person, or in a document leading to the issue of the policy, was inaccurate or false unless the insurer shows that such statement was on a material matter or suppressed a material fact and that it was fraudulently made by the policyholder with the knowledge that the statement was false or that it suppressed a material fact.

This provision is more far-reaching in its scope than the Statement of Long-Term Insurance Practice of England. It immensely restricts the arena open to the insurer in avoiding a life policy which has been in force for two years or more. Neither the mere existence of the 'basis clause' nor the mere fact of the materiality of the non-disclosed information is any longer sufficient ground

for avoiding such policies. The non-disclosed information must not only be material but must also have been fraudulent.

None of the provisions relating to indisputability clauses in s.15C have been applied by the courts. The precise scope and application of these provisions, particularly the lengthy s.15C(4) therefore remains to be seen. The Indian Supreme Court in applying a similar provision in the form of s.45 Life Insurance Act 1938 of India, laid down three conditions before a life policy which comes within the scope of such provision can be challenged by the insurer⁹⁸. First the statement must be on a material matter or must suppress facts which it was material to disclose. Second, the suppression or misstatement must have been fraudulently made by the policyholder and finally, the policyholder must have known at that time that the statement was false or that it suppressed facts which it was material to disclose. This should perhaps be used as a guideline in the application of the Malaysian provision.

98. Mithoolal Nayak v Life Insurance Corporation of India
Op. cit. footnote 95.

CHAPTER FIVE

WARRANTIES AND CONDITIONS

1.0 Introduction

Express stipulations in a contract of insurance are here classified broadly as warranties and conditions. The crucial distinction between them is the way in which the breach of such a stipulation affects the rights and obligations of the parties. While breach of a warranty by the insured enables the insurer to repudiate the policy from the date of breach, generally breach of a condition only enables the insurer to deny liability for a particular claim.

Warranties and conditions in a contract of insurance complement, at the post-contract stage, the role played by non-disclosure and misrepresentation at the pre-contract stage. While the law relating to the latter is mainly intended to ensure that prior to the contract, the insurer is given a fair chance to make a reasonably accurate assessment of the risk to be insured and to determine the level of premium to impose, warranties serve to ensure that the risk as assessed remains true and unchanged throughout the duration of the contract.

While some conditions serve the same purpose as warranties, others generally serve to ensure that on the occurrence of the insured event the insurer is able to quickly and effectively process the claim. Thus while non-disclosure and misrepresentation protect the insurer's interest prior to the contract, warranties protect this interest during the contract, while conditions generally protect their interest after the occurrence of the insured event.

2.0 Warranties

2.1 Definition

The term 'warranty' in the context of insurance law has not been legally defined in Malaysia. The Insurance Act 1963 makes no mention of the term, let alone define it. In most breach of warranty cases the judges have applied the common law and have thus given to warranties in insurance law an effect similar to conditions in other areas of the law, without attempting to give any definition to the term.

Generally a warranty is an express term of a contract of insurance which must be strictly and literally complied with by the party upon whom such a term is imposed - almost always the insured. Breach of a warranty enables the aggrieved party, ie. the insurer, to repudiate the

contract from the date of such breach¹. Often, though this is by no means the rule, the contents of a warranty relate either to the description of the subject matter of the insurance or to the precautions to be taken by the insured to minimise the risk of the occurrence of the insured event.

2.2 Creation of Warranties

The most common means of creating a warranty out of a term in the proposal form is by including therein a declaration signed by the insured to the effect that the particulars given are true and shall be the basis of the contract between him and the insurer. Although it is now generally accepted that the presence of the so-called 'basis of contract' clause does not ipso facto give the status of a warranty to every term in the proposal form², Malaysian judges seem to have accepted the existence of such a clause as conclusive evidence that a particular term has acquired the status of a warranty. In Suhaimi

1. According to Lord Mansfield in De Hahn v Hartley 99 ER 1130 at p.1131, the contract does not exist unless the warranty is literally complied with. This is not entirely accurate not only because a breach of warranty can be waived by the insurer but also because there are circumstances where an insurer may be estopped from relying upon such a breach. See infra. pp.216 - 220.
2. Farr v Motor Traders Mutual Insurance Society [1920] 3 KB 669. See infra. pp.210 - 211.

bin Ibrahim v United Malaya Insurance Co. Ltd., MacIntyre J said:³

Where the statements contained in a proposal formed the basis of a contract of insurance, ... the truth of the statements in the proposal form was a condition of the liability of the insurer.

In China Insurance Co. v Ngau Ah Kau⁴, it was held by the Federal Court that when the truth of the answers in the proposal form had been made a condition of the policy, it was not open to the court to consider the question whether the answer to these questions were material.

A warranty can also be created by the use of the term 'warranty' or any of its derivatives such as 'it is warranted' or 'the insured warrants that...'⁵ According to the case of De Maurier v Bastion Jewellers⁶ however, the use of such a word does not always conclusively create a warranty and that even when such words are used, the intention of the parties has to be considered.

3. [1966] 1 MLJ 140 at p.142.

4. [1972] 1 MLJ 52.

5. In Hock Joo Bee v The Asia Insurance Co. [1931] SSLR 21 it was held that a clause in a fire policy which read: 'Warranted that no hazardous goods ... will be stored' amounted to a warranty the breach of which enabled the insurer to avoid the policy.

6. [1967] 2 Lloyd's Rep. 550.

Warranties can also be created by the use of other words or phrases which clearly indicate that the parties intend to regard the contract as void if a particular term is not complied with. For instance the use of phrases like 'the validity of this policy is conditional upon...' clearly indicate such an intention and will also have the same effect.

The use of the phrase 'condition precedent' will have the effect of creating a warranty if the validity of the entire policy, as opposed to the insurer's liability for a particular claim, is dependent upon compliance with such a condition precedent. As a breach of a condition of this nature enables the insurer to avoid the entire contract ab initio, in spite of its label, such a condition precedent is in fact a warranty.

In Fook Yew Timber Co. v The Public Insurance Co.⁷, the plaintiff had an employer's liability policy issued by the defendant. One of the conditions precedent for the renewal of the policy was that the insured should report to the insurer the actual amount paid in wages and the number of employees for the previous year. This was not done when the insured renewed the policy although the

7. (1960) 26 MLJ 72.

number of employees had increased. It was held that on renewal of the policy the insured had not only been in breach of a duty of disclosure but had also been in breach of a warranty in not fulfilling the condition precedent. The policy as renewed was thus void ab initio.

2.3 Types of Warranties

Warranties are of three different types. It is crucial to identify to which of these three types a particular warranty belongs as the legal implications of the breach of each type differ from that of the others.

2.3.1 Affirmative Warranties

Also known as warranties as to past or present facts, these are contractual stipulations the truth of which is guaranteed by the insured at the time of the making of these stipulations. As its name suggests, warranties of this type relate to past or present facts only. Affirmative warranties can usually be identified by looking at the language and the nature of a particular stipulation. Generally if the language used refers only to the past or to the present, then such a warranty is an affirmative warranty. There are however two exceptions to this. The first is when the warranty, although stated in the present tense must in the circumstances, be construed as referring to the future. The warranty, although

ostensibly affirmative, will then be treated as promissory.

In Beauchamp v National Mutual Indemnity Insurance Co.⁸, a warranty in a policy effected by a builder who had never carried out demolition work before stated that he did not use explosives in his business. This was held to be a promissory warranty although the warranty was expressed in the present tense as the warranty could not possibly have referred either to the past or the present.

The second exception is that warranties are usually deemed to be promissory, even if the present tense is used, if it relates to measures to be taken by the insured to minimise the risk of the occurrence of the insured peril. In Hales v Reliance Fire and Accident Insurance Co.⁹, in a proposal form which contained a 'basis of contract' clause, the insured was asked, 'Are any inflammable oils or goods used or kept on the premises?' The answer given was 'Lighter fuels'. It was held that the question and answer was a promissory warranty although the present tense was used in the question.

Although both the above decisions seem to be logical, they seem to be inconsistent with the basic rule in

8. [1937] 3 All ER 19.

9. [1970] 2 Lloyd's Rep. 391.

construing such documents, ie. where there is an ambiguity, it should be construed contra proferentem. After all it is not difficult for the insurer who wishes to create a promissory warranty to use words which clearly and precisely show such an intention¹⁰.

2.3.2 Promissory Warranties

As opposed to affirmative warranties there are promissory or continuing warranties. These are warranties that remain in force and hence must be exactly complied with, throughout the lifespan of a contract of insurance. The recognition of this type of warranty is justified by the fact that the insurer has agreed to accept a particular risk at a particular premium based on the facts given to him before the contract. He is therefore entitled to devise a means of ensuring that the risk as assessed and the premium as fixed remain unchanged throughout the duration of the policy. The effective means of doing so is through the instrumentality of promissory warranties.

Like affirmative warranties, promissory warranties can come into being in a number of ways. The basic rule however is that to be a promissory warranty a contractual

10. This point was made by Lord Greene in Woolfall & Rimmer v Moyle [1942] 1 KB 66 at p.71 in rejecting an argument similar to that in Hales.

stipulation must be clear and unambiguous in its language. If there is any ambiguity the courts will normally regard such a stipulation to be something other than a promissory warranty¹¹.

Words precisely to that effect are sometimes used to create a promissory warranty. For instance, 'this warranty shall be deemed to be of a promissory nature and effect'¹². The use of future tense or of words showing an intention to refer to the future is also generally regarded as having the effect of creating a promissory warranty¹³. Sometimes a promissory warranty can also be created by the use of the present tense, if from the circumstances, the warranty can only be regarded as referring to the future¹⁴.

2.3.3 Warranties of Opinion or Belief

A warranty of opinion or belief is usually created by the inclusion of phrases to that effect either in the questions asked by the insurer or in the answers given by the insured. When there is such a reference to the

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11. Kennedy & Ors. v Smith & Ansvar Insurance Co. Ltd. (1976) SLT 110.
 12. Leong Chee Yeong v China Insurance Co. (1952) 18 MLJ 246.
 13. Suhaimi v United Malaya Insurance Co. [1966] 1 MLJ 140.
 14. Hales v Reliance Fire and Accident Insurance Co. Op. cit. footnote 9.

insured's opinion or belief, the statements so made are not regarded as either affirmative or promissory warranties but as warranties of opinion or belief. This is so even if the proposal form contains a 'basis of contract' clause¹⁵.

In Tan Choo Nik & Anor. v American International Assurance Co. Ltd.¹⁶, the plaintiffs were administrators of the estate of the deceased who had a life policy issued by the defendant. The plaintiffs' claim for the insured sum on the insured's death was rejected by the defendant who contended that the policy was void. One of the grounds given was that the insured had declared in his proposal form that his health was not impaired in any way when he in fact was suffering from dysphagia and cancer of the oesophagus. The relevant questions relating to the insured's health in the proposal form were all preceded by the phrase 'to the best of your knowledge and belief'. The proposal form also had a 'basis of contract' clause. Another statement in the proposal form stated that 'All statements made in applying for the insurance will in the absence of fraud, be deemed representations and not warranties'. Syed Agil J relied primarily upon this clause in deciding that in the absence of fraud,

15. Huddleston v RACV Insurance Pty. Ltd. [1975] VR 683.
16. [1982] Malaysian CLJ 570.

all statements in the proposal form could only be regarded as representations and not warranties. The learned judge however also held that even if such a clause had been absent, the answers relating to the insured's health could not be regarded as affirmative warranties inspite of the presence of the 'basis of contract' clause. He cited as authority the decision in Joel v Law Union and Crown Insurance Co.¹⁷ where it was held that if a statement which could not be based on the proposer's own knowledge was required to be true, an express warranty making the truth of the answers a condition precedent to the liability of the defendants on the policy was necessary. Finally, according to the learned judge, a warranty of opinion as to health is sufficiently complied with if it was made according to the honest belief of a layman¹⁸.

2.4 Interpretation of Warranties

Attempts have on numerous occasions been made by judges to mitigate the harsh effects of the law relating to warranties by resorting to the use of particular principles of construction such as the contra proferentem rule in construing such stipulations in a contract of

17. [1908] 2 KB 863.

18. Op. cit. footnote 16 at p.572.

insurance. For instance, an ambiguous stipulation in a contract of insurance has often been construed to be something other than a promissory warranty¹⁹.

In The Cycle and Carriage Co. v The Motor Union Insurance Co.²⁰, referring to the language and interpretation of a warranty in a fire policy, Sproule Ag. CJ said:²¹

[T]he insurer cannot lay traps, and if there is any doubts, strict construction must be applied, not in his favour but against him.

In Hock Joo Bee v The Asia Insurance Co.²², it was contended on behalf of the insured that as a warranty relating to the storage of hazardous goods in a fire policy was bad due to uncertainty and ambiguity, it should be disregarded. This contention though seemingly consonant with the contra proferentem rule was rejected by the learned judge who favoured another principle of construction, ie. that of trying to render a business contract effective instead of futile. According to him:²³

It is our duty to render this business contract effective instead of futile, if we can; and it is enough to do so.

19. See eg. Farr v Motor Traders Mutual Insurance Society Op. cit. footnote 2, and De Maurier v Bastion Jewellers Op. cit. footnote 6.

20. [1931] SSLR 69.

21. Ibid. at p.77.

22. Op. cit. footnote 5.

23. Op. cit. footnote 5 at p.221.

It is indeed unfortunate that the learned judge chose to equate construing a clause contra proferentem with rendering the entire contract futile. Such an equation is not only inaccurate but seems to lean unjustifiably in favour of the insurer. The application of the contra proferentem rule does not render a contract futile, rather it gives the ambiguous clause an interpretation in favour of the party aggrieved by such an ambiguity, ie. the insured. As it involves merely an approach in the interpretation of a contract, it does not destroy or make futile the very existence of the contract itself.

The contra proferentem rule should, it is submitted, be applied not only in construing lengthy warranties drafted by the insurer but also in construing ambiguous questions in the proposal form which binds the insured, by virtue of the basis of 'contract clause', to answer correctly. As such if the questions are ambiguous, then such an ambiguity should be read in the insured's favour. If his answers to such questions are reasonably or substantially correct though not literally accurate, he should not be held to have been in breach of a warranty. This approach was regrettably not followed in Leong Chee Yeong v China Insurance Co.²⁴. In a proposal form for a life policy, the insured was asked his 'Profession or

24. Op. cit. footnote 12.

Occupation'. The insured wrote 'Merchant'. When asked, 'Is there anything hazardous about your occupation or pursuits?', the insured wrote 'No'. During the currency of the policy, the insured became an Auxilliary Police Inspector besides carrying out his work as a merchant. He was killed on his first day of duty when a hand grenade exploded. In considering whether the questions in the proposal form had been correctly answered, the learned judge held that the phrase 'occupation or pursuits' was wide enough to include anything which a man did even though no emolument or remuneration was received and so by becoming an Auxilliary Police Inspector the insured had been in breach of a warranty even though he remained a merchant as well.

By adopting a liberal interpretation to vague questions in the proposal form the learned judge had failed to reflect the need for insurers to carefully and clearly phrase the questions in the proposal forms, a matter of utmost importance given the far - reaching legal implications of the 'basis of contract' clause. When a layman is asked his occupation he will most likely take it to mean what he does for a living and will not include anything which he does on a voluntary basis. When such a question is followed by another referring to 'occupation or pursuits' it can be reasonably expected that he will

relate this to the preceding question and interpret it to mean whether what he does for a living is dangerous. As the questions in the proposal forms are framed by the insurers, any ambiguity should be interpreted contra proferentem.

Another important principle in construing a warranty is that a clause which has the effect of excluding the insurer's liability must, in order to be effective, be couched in extremely clear and precise terms so that the intention to exclude liability in certain circumstances is made very clear to the insured. Failure on the part of the insurer to use such clear language can result in the court's refusal to give effect to such a clause.

In New India Assurance Co. v Woo Chin Fong²⁵, the proviso to s.1 in a motor policy provided that no compensation should be payable in respect of death or injury resulting from an accident whilst the insured was under the influence of intoxicating liquor or drugs. An accident occurred whilst the insured was driving under the influence of intoxicating liquor, resulting in the total loss of the car. In denying liability for the loss of the car the insurer contended that in driving the car whilst

25. (1962) 28 MLJ 432.

under such influence, the insured had been in breach of Condition 3 in the policy which required the car to be kept in an efficient working condition. This was rejected by the learned judge who reasoned:²⁶

[I]f it was the intention of the [insurer] that no compensation should be payable in respect of loss or damage to the car resulting from an accident happening whilst the insured was under the influence of intoxicating liquor or drugs, they would have inserted a proviso to that effect in s.1. It seems clear to me that their failure to do so shows that they had no such intention at the time of making the policy.

3.0 CONDITIONS

3.1 Definition

A condition in a contract of insurance is a contractual stipulation which is not a warranty and is therefore collateral to the contract. Conditions are of different types and serve different purposes - some relate to the risk insured against, others relate to the payment of the premium while still others relate to the procedure to be followed after the occurrence of the insured event. Breach of a condition by the insured does not entitle the insurer to repudiate the contract, it merely allows them to deny liability for a particular claim which is

26. Ibid. at p.433.

related to such a breach.

3.2 Conditions Precedent to the Insurer's Liability for a Claim

These are conditions precedent in the true sense of the word as conditions precedent to the validity of a policy are in fact warranties. Breach of a condition precedent to the insurer's liability for a claim only entitles the insurer to avoid liability for a particular claim which is connected with such breach. Conditions of this type are usually in the form of obligations imposed upon the insured which come into play on the occurrence of the insured event such as the giving of notice of loss, the prohibition against settling any claims with third parties and the giving of notice of any intended prosecution.

A mere stipulation in a policy that notice of loss or claim be given within a certain time is not in itself a condition precedent to liability²⁷. Whether a particular stipulation is a condition precedent is a question of intention. Such an intention is clear when a clause in the policy states that the non-fulfilment of a particular condition shall disentitle the insured from

27. Stoneham v Ocean, Railway & General Accident Insurance Co. (1887) 19 QBD 237.

recovery under the policy. According to Murrison CJ in Lee Seng Heng & Ors. v The Guardian Assurance Co. Ltd.:²⁸

Whether a particular stipulation is intended to be a condition precedent or not is a question of intention ... Where there is a stipulation saying that non-fulfilment of a condition shall disentitle the assured from recovery, the intention of the parties is clearly shown and the stipulation must be construed as a condition precedent.

The plaintiff in this case had a fire policy issued by the defendant. After a fire the plaintiff gave a verbal notice to the defendant's clerk. This was done inspite of Clause II in the policy which stipulated that a written notice must be given within fifteen days and that no claim under the policy would be payable unless this condition had been complied with. It was held to be clear from the wording of Clause II that the said clause was intended by the parties to be a condition precedent to the liability of the insurers for any claim under the policy and as the plaintiffs had not complied with it their claim failed.

3.3 Clauses Descriptive of Risks and Exclusion Clauses²⁹

Both these clauses, as their names suggest, delimit the nature and scope of the risk covered by a particular

28. (1932) 1 MLJ 17.

29. See also Chapter Twelve - Third Party Motor Insurance.

policy. While clauses descriptive of risks describe and circumscribe the risks in positive terms, exclusion clauses complement them by defining the risks in negative terms, ie. by describing the situations which are excluded by the policy.

Clauses descriptive of risks and exclusion clauses are an integral part of an insurance contract. However it was only fairly recently that the common law courts recognised these clauses to be in a class of their own, separate and different from either warranties or conditions generally. This recognition in fact represents a judicial reaction to the unsatisfactory state and harshness of the law relating to warranties.

In what must have been the earliest case where clauses descriptive of risks were recognised, Farr v Motor Traders Mutual Insurance Society³⁰, the plaintiff who was insuring his two taxis was asked in the proposal form to 'State whether the vehicles are driven in one or more shifts per 24 hours'. He answered 'Just One'. On one occasion during the currency of the policy one of the taxis had to be repaired so the other was driven in two shifts within 24 hours. An accident occurred involving

30. Op. cit. footnote 2. This case cited no earlier cases where such clauses had been so recognised.

one of the taxis at a time when both were being used as normal, ie. one shift a day. The insurer denied liability on the ground that as the taxis had on one occasion been used on two shifts, the insured had been in breach of a warranty. It was held that the insurer was liable as the statement in the proposal form that each taxi would only be used for one shift per day was not a promissory warranty but a clause descriptive of risk. If the accident had occurred at a time when such a clause was breached, the insurer would not have been liable as they were not at risk when a clause descriptive of risk was not being complied with.

A similar decision was reached in Provincial Insurance Co. Ltd. v Morgan³¹ although there seems to be a degree of uncertainty in that case as to whether the relevant clause was a clause descriptive of risk or a promissory warranty which had not in fact been breached by the insured.

In Malaysia, although no such specific label was used, clauses descriptive of risks were first recognised in the criminal case of Dodds v Regina³². The appellant who rode a motor cycle without displaying an L-plate was charged

31. [1933] AC 240 (HL).

32. (1964) 3 MC 320.

and convicted for that offence as well as for the offence of using a motor cycle without a third party insurance. He appealed against the second conviction as he had at the time of the offence a third party policy. The prosecution however contended that since the appellant had been in breach of a statutory provision by not displaying the L-plate, a proviso in the policy applied and the appellant was not covered by the policy at that time. The court agreed and held that as the appellant was at that time in breach of a term in the policy, the insurer would not have been liable if a third party had been injured then³³. This meant that the appellant did not have the required insurance cover at that time.

Although the learned judge referred only to a breach of a 'term of the policy' without attempting to give a definite label to the said term, his reasoning seemed to show that he regarded the said term either as a clause descriptive of risk or as an exclusion clause. This is because he held that the insurer would not be liable if a third party had been injured at a time when this term was broken. He did not regard the policy to be void, which would have been the inevitable conclusion if he had

33. This argument is erroneous. Under s.80 of the Road Traffic Ordinance 1958, the insurer would still be liable to a third party in such a situation although they could afterwards recover the amount paid from the insured.

considered the term to be a warranty.

Clauses descriptive of risks and exclusion clauses were again considered in Leong Chee Yeong v China Insurance Co.³⁴. In holding that the insurers were not liable under a life policy, the learned judge inter alia reasoned that the insured had been in breach of a promise when he became an Auxilliary Police Officer. In so doing the learned judge summed up the law relating to clauses descriptive of risks:³⁵

Where there is a proposal which in terms has been incorporated in the policy and which has been stated to be its basis then the courts have regarded the statements contained in the proposal in one of two ways. Either they have regarded these statements as promises that a certain state of things shall continue or a certain course of conduct shall be continued during the whole period covered by the policy so that if the particular promise is not kept the policy is invalidated or they have regarded these promises as merely descriptive of the risks so that if the accident happens while the state of things subsists there is a valid claim, but if the accident happens while the state of things has ceased or been interrupted there is no valid claim.

Having clearly distinguished clauses descriptive of risks from warranties, the learned judge unfortunately refused to decide whether the clauses in question in that case, ie. that the insured was a merchant and that there was

34. Op. cit. footnote 12.

35. Op. cit. footnote 12 at p.252.

nothing hazardous in his occupation or pursuits, were one or the other. He justified his refusal to make the ultimate decision in the following words:³⁶

On the law as I have stated it, it is impossible to regard the insured's statement as to his profession or occupation and pursuits otherwise than as a promise, and if the accident whereby he died occurred while he was in breach of that promise it seems to me immaterial whether it be regarded as a promise that he would continue a certain course of conduct throughout the duration of the policy or merely as a description of the risk. The promise was that he was a merchant ... When he assumed duty as an Auxilliary Police Inspector, that promise was broken.

While it is true that every term of a contract is essentially a promise, the learned judge's refusal to give the broken promise a label which is more specific and more familiar in insurance law is regrettable. While he was right in saying that such a labelling would not have made any difference to the final outcome of the case before him, identifying the nature of the broken promise would have enabled us to identify the precise reason for the non-liability of the insurer and the legal implications therewith. If the so-called broken promise was a warranty, the policy was void from the date of the breach and the insurer would not have been liable for any claims arising thereafter even if the insured had met his death in a way unconnected to his duties as an Auxilliary

36. Ibid.

Police Inspector. On the contrary, if the promise was a clause descriptive of risk, the policy would have remained valid until the insured's death. Its cover however would be suspended whenever the insured assumed his police duties.

3.4 Arbitration Clauses³⁷

Arbitration clauses are in effect a variety of conditions precedent to liability. These clauses normally stipulate that any dispute arising out of a claim under the policy must first be referred to arbitration. An arbitration clause becomes a condition precedent to liability if, as is common, it makes it clear that such a reference to an arbitrator is a condition of any claim or any action in court. Failure in such a case to refer a dispute to arbitration is fatal to the insured's particular claim under the policy. In Suhaimi v United Malaya Insurance Co.³⁸, one reason given by the insurer in denying liability was that the insured had been in breach of a condition in the policy which required a dispute to be referred to arbitration within twelve months from the date when liability was disclaimed by the insurer. This contention was accepted by the learned judge who found on the evidence that the insured had failed to refer the

37. See also Chapter Eight - Claims.

38. [1966] 1 MLJ 140.

matter to arbitration although he was aware that the insured had disclaimed liability.

4.0 Breach of Warranties and Conditions

4.1 Effect of Breach³⁹

Affirmative and promissory warranties must be literally and strictly complied with. Breach of either of them enables the insurer to avoid the policy from the date of the breach. As the insured warrants the truth of an affirmative warranty at the time he enters into the contract of insurance, breach of such a warranty enables the insurer to avoid the contract ab initio. On the contrary, with a promissory warranty the insured warrants its truth throughout the duration of the policy and so a breach of such warranty at any time during the lifespan of the contract enables the insurer to avoid the policy from such date. If a promissory warranty is breached from the first day of the contract, then its effect will be the same as that of a breach of an affirmative warranty, the insurer being entitled to repudiate the contract ab

39. In England the strict law is not always applied in this respect because of the Statements of Insurance Practice issued by the Association of British Insurers and Lloyd's. No parallel statements have been issued by Malaysian insurers. There are however provisions in the Insurance Act 1963 which introduce statutory indisputability clauses in relation to life policies which have been in force for two years or more. See Chapter Four - Non-Disclosure, Misrepresentation and Fraud.

initio. Any breach of warranty is fatal to the contract irrespective of either the materiality⁴⁰ of the warranty or the causal connection between the breach and the loss.

A warranty of opinion or belief is breached if the insured is dishonest or fails to exercise due care in making it⁴¹. An honest opinion or belief which subsequently proves to be wrong is not fatal to the contract.

Breach of a condition precedent to liability allows the insurer to avoid liability only for a particular claim which is directly related to such breach. In third party motor insurance an insurer who had settled a third party claim is entitled to recover the amount so paid if the insured had been in breach of a condition in the policy. In Public Insurance Co. Ltd. v Muthu⁴² the insurer sought to recover from the insured a sum of money which they had paid to a third party who was injured in an accident with the insured as the insured had failed to comply with a condition in the policy which required him to give written notice of any loss or possible claim or of any impending prosecution. The learned judge found that the

40. China Insurance Co. v Ngau Ah Kau Op. cit. footnote 4.

41. Huddleston v RACV Insurance Pty. Ltd. Op. cit. footnote 15.

42. [1965] 2 MLJ 201.

insured had not complied with the condition and allowed the insurer to recover:⁴³

Under the compendious 'condition precedent' clause the due observance and fulfilment of the terms and conditions of a policy is a condition precedent to liability on the part of the company, and the position is not affected by the fact that damages have already been paid to the injured party under the policy. The right to recover is inherent in the terms.

Breach of clauses descriptive of risks or exclusion clauses allows the insurer to deny liability only for losses which occur at the time when such clauses are breached⁴⁴. It is for this reason that such clauses are also known as suspensive conditions.

4.2 Proof of Breach

The legal burden of proving breach of a warranty or a condition rests upon the party alleging such a breach, which is usually the insurer. The insurer must adduce sufficient evidence to convince the court, on a balance of probabilities, that the insured has been in breach of a particular warranty or condition⁴⁵.

43. Ibid.

44. Farr v Motor Traders Mutual Insurance Society, Op. cit. footnote 2 and Provincial Insurance Co. Ltd. v Morgan Op. cit. footnote 31.

45. Bond Air Services Ltd v Hill [1955] 2 QB 417 at pp.427 - 428, per Lord Goddard CJ.

In Malaysia Rubber Development Corporation v Malaysia National Insurance Sdn. Bhd.⁴⁶, the defendant insured rubber belonging to the plaintiff under a Goods in Transit Policy. The rubber was destroyed when a fire gutted the plaintiff's godown. The defendant denied liability inter alia on the ground that the rubber was not in transit when it was destroyed and so a clause which excluded the insurer's liability when the rubber was stored in a godown for the purposes of storage, making-up, processing or packing, applied. At the time when it was burnt down the rubber was temporarily stored in the godown after being collected from various centres, prior to being sent to the port for export. The insurer however failed to adduce sufficient evidence to show that the rubber was stored in the said godown for the purposes mentioned in the exclusion clause and the High Court found them liable under the policy. Their appeal to the Supreme Court inter alia in relation to the nature of evidence and burden of proof required for the exclusion clause to apply, failed and the decision of the High Court was affirmed.

4.3 Waiver of Breach

A breach of warranty need not automatically and

46. [1986] 2 MLJ 124.

inevitably result in the repudiation of the contract by the insurer. The insurer may opt to waive such a breach, as a result of which the contract remains intact and the parties remain bound by the rights and obligations thereunder as if a breach of warranty had not occurred. An insurer is deemed to have waived a breach of warranty if, after knowing of such a breach, the insurer continues to exercise the powers conferred to them by the policy as if the policy remains valid and in force.

In The Cycle and Carriage Co. v The Union Motor Insurance Co.⁴⁷, fire policies issued by the defendant to the plaintiff contained warranties to the effect that none of the goods mentioned in an annexed list of hazardous goods would be in or upon the insured premises during the currency of the policies. The list mentioned inter alia, oils of all kinds except essential oils, linseed oil in drums and castor oil in tins. After a fire gutted down the insured premises, the plaintiff claimed on the policies issued by the defendant, which insured different parts of the premises and the different contents therein against fire. The defendant pleaded breach of the warranty relating to storage of hazardous materials.

47. Op. cit. footnote 20.

According to the evidence, the insurer after knowing of the alleged breach of warranty, continued to exercise the rights conferred to them under the policies by taking possession of the premises and realising the plaintiff's goods by way of salvage. Relying on this evidence the plaintiff contended that the defendant had waived the breach of warranty. Sproule Ag. CJ agreed:⁴⁸

[T]he fire occurred on the night of 16th - 17th April 1929. Notice of loss was given by the plaintiffs the next day ...

Before the end of April ... they had all the evidence they now possess of the breach of warranty of hazardous goods ... and could have repudiated the contract and denied the liability.

What they actually did was to enter upon ... and take possession of the premises and the property of the plaintiffs thereon on 1st May.

Then upon 2nd May, plaintiffs asked for an extension of time to file their claims in detail under Condition 2. Defendants did not set up the breach of warranty, they granted the extension.

The effect of these acts was an election by the defendants to treat the contract and the plaintiff's claim under it as valid and subsisting ... and thereby affirmed the contract.

The learned judge cited as authority the Privy Council

48. Op. cit. footnote 20 at p.71.

decision in Yorkshire Insurance Co. v Craine⁴⁹ whereby after a fire had occurred at the insured premises but before any claim was made, the insurer's agent went into possession of the said premises and allowed the insured to enter only with his permission. On being sued for the insured sum, one of the defences raised by the insurer was that the insured had never submitted to them a claim as was required by the policy. The insured pleaded waiver by virtue of the insurer's entry into and continued possession of, the premises. According to Lord Atkinson, it was illegal for the insurer to enter the insured premises unauthorised by the terms of the policy, until and unless a claim had been filed. However if the company did so, they were estopped from disputing the claim as they could not set up that their own act of entry was illegal.

To successfully plead waiver the insured must adduce evidence to show that the insurer had, after acquiring knowledge of the breach, shown an intention to treat the contract as subsisting. In Public Insurance Co. v Muthu⁵⁰, the insured contended that an alleged breach of condition on their part had been waived by the insurer. The sole basis for this contention was that in a letter

49. [1922] AC 541.

50. Op. cit. footnote 42.

written earlier by the insurer's solicitor conveying their intention to repudiate the contract, the breach of the particular condition precedent was not mentioned as a ground for the intended repudiation. The learned judge rejected the insured's plea of waiver because there was insufficient evidence to support it. According to him:⁵¹

The burden of proof to show waiver is a strict one. I can find nothing in the content of the letter ... or the conduct of the plaintiffs to show that after the breach the plaintiffs have an intention to treat the contract as still subsisting between the parties. The [insured] has not discharged his burden in this respect.

51. Op. cit. footnote 42 at p.202.

CHAPTER SIX

PREMIUMS

1.0 Introduction

1.1 Definition

The premium in a contract of insurance is the consideration from the insured to the insurer, in return for the undertaking by the latter to pay the former on the occurrence of the insured event. Although ordinarily the premium takes the form of the payment of a sum of money, this need not necessarily be the case. In mutual insurance for instance, the premium may be in the form of an obligation to contribute to the losses of others¹.

While the size of the premium is usually a reflection of the insurer's assessment of the risk, it is in fact of no consequence to its validity as a consideration for the contract. Anything that qualifies as a valid consideration for an ordinary contract qualifies as such a consideration in a contract of insurance.

1. Lion Insurance Association v Tucker (1883) 12 QBD 176.

1.2 The Premium and the Contract of Insurance

An insurance contract being essentially executory in nature, the actual payment of the premium is not generally a pre-requisite either for the formation of such a contract or the commencement of cover thereunder unless there are express stipulations to that effect².

While cover under a fire policy usually commences immediately irrespective of whether or not the premium has been paid, contracts of life insurance normally stipulate that the provision of cover thereunder does not commence until after the payment of the first premium. A third party motor insurance is ineffective unless the insurer has delivered to the insured a certificate in the prescribed form³. Such a certificate is not usually issued until after the premium is paid.

While neither the payment of the premium nor an agreement as to its precise amount is a pre-requisite to the formation of a contract of insurance, the parties to such a contract must have reached some form of agreement as to

2. McElroy v London Assurance Corporation (1897) 24R (Ct. of Sess.) 287 at p.291, per Lord MacLaren. See also Thompson v Adams (1889) 23 QBD 361 where the premium was not tendered until after the loss.

3. Road Traffic Ordinance 1958, s.75(4).

the premium before the contract can be concluded⁴. They may agree that the amount be reasonable or that it be determined by a third party. Complete uncertainty as to the premium precludes the existence of the contract.

In non-life insurance, Malaysian insurers are statutorily prohibited from providing cover before either the premium or a deposit thereof is received or is guaranteed to be paid in a prescribed manner and at a specified time. An insurer who acts in contravention of this prohibition is liable to be fined⁵ but the effect of such a contravention on the contract itself is not clear. According to the Court of Appeal in Phoenix General Insurance Co. SA Greece v Administratia Asiguraliror de Stat⁶, where a statutory prohibition is a unilateral one ie. imposed by the statute upon one of the contracting parties only, it does not automatically follow that a contract entered into in contravention of such a prohibition is illegal and void. This depends on a consideration of public policy in the light of the mischief which the prohibition was designed to prevent. The 'cash before cover' provision in the Insurance Act was intended to protect insurers by preventing them from

4. Murfitt v Royal Insurance Co. 10 Ll. L Rep. 191 and Allis-Chalmers & Co. v Maryland Fidelity Deposit Co. (1916) 114 LT 43.

5. Insurance Act 1963, s.14A(1).

6. [1986] 2 Lloyd's Rep. 552.

undertaking risks for which no premium has been received. If in contravention of such a provision an insurer chooses to provide cover before receiving the premium, it is submitted that the contract should not be illegal and void but should be enforceable by the insured as the innocent party.

Whether, having agreed to insure a particular risk at a specified premium, the insurer can afterwards refuse to accept the premium when tendered seems to depend upon two factors.

The first is whether there has been a change in the risk between the earlier negotiation and the tender of the premium. If there has been such a change, according to the decision in Canning v Farquhar⁷, an insurer is entitled to refuse the premium tendered.

The court in that case however left unanswered the question whether the insurer could legally have refused the premium if there had been no alteration in the risk. The answer to this seems to depend upon the second factor - the legal status of the preliminary arrangement. If the preliminary arrangement is merely a negotiation prior to contract which is supposed to be culminated by the

7. (1886) 16 QBD 727.

formation of a contract when the premium tendered is accepted, then there is no obligation on the part of the insurer to accept the premium irrespective of whether or not there has been a change in the risks. If the preliminary arrangement is in fact a contract, then the tender of the premium and the provision of cover would amount to the performance of an existing contract. Failure of either party to perform his share of the bargain would thus be in breach of the contract.

The crucial question is thus whether there is a binding contract at the time the premium is tendered. In Canning v Farquhar, Lord Esher MR regarded the preliminary arrangement including the filling in of the proposal form as being made preliminary to the moment of insurance and was therefore a mere expression of an intention to insure by one party and to accept the risk by the other⁸. His Lordship was thus of the view that there was no contract binding the insurer to accept the premium.

A contrary decision was taken by the Malaysian Supreme Court in Borhanuddin bin Haji Jantara v The American Insurance Association⁹. About two weeks before an air

8. Ibid. at p.731.

9. [1987] 1 MLJ 22. See Chapter Two - Contractual Formalities.

stewardess was involved in a fatal plane crash, she submitted a proposal for life insurance with the respondent. Thereafter she paid a sum of (M)\$118.00 for which a receipt was issued. At the time of her death the insurer had not issued her with a policy. At the High Court it was held that there was no concluded contract at the time of the insured's death and the respondent was not liable. This decision was reversed by the Supreme Court on the ground that there was a binding contract from the moment the insured's proposal was accepted. As such the payment of the premium by the insured and the issue of a policy by the insurer were regarded as the performance by the parties of their obligations under an existing contract. Failure by either party to perform their part of the bargain would therefore amount to a breach of contract.

1.3 Regulation of Premiums for Life Policies

In Malaysia, the rate of premium chargeable for a life policy is statutorily regulated. The Insurance Act provides that an insurer shall not issue a life policy of any description if the premium chargeable thereunder is not in accordance with rates fixed with the approval of a qualified actuary. If no such rates have been so fixed for a particular type of policy the premium must be one that has been approved for the policy by a qualified

actuary¹⁰. In approving a premium for a policy or a rate of premium for a particular description of life policy, the actuary must be satisfied that such premium or rate of premium is suitable and in accordance with sound insurance practice¹¹.

In determining what premium or rate of premium to approve, the actuary must take into account the maximum commission which is proposed to be paid to any person in respect of that policy and this amount must be certified by him¹². In order to ensure compliance with these provisions, the Director-General of Insurance is empowered to require an insurer to furnish him with an actuary's report as to the rates of premium for the time being chargeable by the insurer for any particular description of life policy¹³. Breach of any of these provisions by the insurer amounts to a criminal offence¹⁴.

The Life Assurance Companies (Compulsory Liquidation) Act 1962 which was introduced during the period of the

10. Insurance Act 1963, s.15(1).

11. s.15(2).

12. s.15(3).

13. s.15(4).

14. This again raises the question whether a policy issued in contravention of these provisions is enforceable by the insured. See Supra. pp.223 -224.

'Malayan Mushrooms' and remains in force today has even more stringent controls over premiums for life policies. It allows the Director-General of Insurance to petition for the winding-up of the insurance company concerned if the premiums charged are inadequate or are not graduated according to the age of the insured or when such graduation is by more than four year intervals¹⁵.

The reason behind these tight controls over the premiums for life policies can perhaps be best explained by the fact that both the Insurance Act 1963 and the Life Assurance Companies (Compulsory Liquidation) Act 1962 were introduced at a time when the life insurance industry in the country had barely recovered from the scandal caused by the 'mushroom' companies. These provisions serve to prevent insurers from issuing policies at unrealistically low premiums only to realise later that they could not meet their obligations.

2.0 Payment of Premiums

Based on the general legal principle that unless the contract stipulates otherwise, it is for the debtor to seek the creditor and not vice versa, it is the responsibility of the insured to pay the premium, not

15. s.3.

that of the insurer to collect them. The strict application of this principle is clearly illustrated in Lai Ah Heng & Anor. v China Underwriters Ltd.¹⁶. One of the reasons given by the insured in seeking a declaration that a life policy had not lapsed for the non-payment of the second and subsequent premiums was that it was impossible for the premium to be paid because during the period of the Japanese Occupation in Malaya, the insurer had suspended their business in the country and had not appointed agents to collect the premium. In rejecting this contention, Gordon-Smith Ag. CJ said that there was no obligation or legal duty on the part of the insurers to collect or even to attempt to collect, the premiums¹⁷.

Prima facie premiums must be paid in cash at the insurer's principal office. In practice however the place, mode and time of payment of the premium are usually expressly stipulated in the policy.

2.1 Payment to the Insurer's Agent¹⁸

Premiums can be paid to the insurer's agent provided the agent is authorised to receive them on the insurer's

16. (1948-49) MLJ (Supp.) 85.

17. Ibid. at p.86.

18. See also Chapter Seven - Intermediaries.

behalf. Such authority may be expressed or implied. An agent may also have the ostensible authority to receive such premiums. If the insured pays the premium to someone who has no authority to receive it, the insurer can cancel the contract for non-payment of premium¹⁹. If an agent is only authorised to receive the premium in a specific form, payment to him can only be made in that form²⁰. Under the Insurance Act, where the premium is received by an agent or a broker on behalf of the insurer, such receipt shall be deemed to be receipt by the insurer. The onus of proving that the person receiving the premium was not authorised to receive it lies upon the insurer²¹.

2.2 Days of Grace

If the renewal premium in non-life policies or the second or subsequent premiums in life policies are not paid by the due date and if the continuance of cover is conditional upon the payment of such premium, legally the policy lapses immediately after the date the premium is due. In practice the harshness of this general rule is mitigated by the policy expressly allowing a certain number of 'days of grace' after the due date, for the

19. Lee Cheng Oo & Ors. v China Insurance Co. Ltd. (1962) 28 MLJ 297.

20. Acey v Fernie 151 ER 717.

21. s.14(A)(2).

insured to pay the premium before the policy lapses. In Malaysia as in England, for non-life policies such as fire, theft or accident, fifteen days of grace is commonly allowed while for life policies a period of thirty days is usually allowed. In both countries it is generally accepted that no days of grace can be allowed for third party motor policies because the Road Traffic Acts of both countries provide that such a policy cannot be effective unless a certificate of insurance is issued and such a certificate is not issued before the premium is paid²².

Whether the insured is covered during the days of grace but before the payment of the premium depends basically upon the type of policy in question and the stipulations therein. In a short-term policy as the insurer is entitled to refuse to renew the provision of cover, the insured is not normally covered during such a period until the premium is in fact tendered and accepted within the days of grace²³. If the policy expressly stipulates that the insured is held covered during the days of grace then such a stipulation is effective unless the insurer indicates his refusal to renew the policy

22. Road Traffic Ordinance 1958, s.75(4) (Malaysia) and Road Traffic Act 1972, s.147(1) (UK).

23. Simpson v Accidental Death Insurance Co. 140 ER 413.

prior to that period. In life insurance, the insurer is not entitled to decline to continue the provision of cover. However whether the insured is covered during the days of grace but before the tender of the premium depends primarily upon the terms of the policy. Most policies in fact clearly define the position of an insured who dies during this period. If there are no definite stipulations in the policy, the established principle is that payment within the days of grace is equivalent to payment on the due date. Thus if an insured dies during this period and the premium is thereafter paid by his representatives within the remaining days of grace, the insurer must accept the premium²⁴.

2.3 Effect of Non-Payment

It is customary for insurers to send further reminders to the insured if the premium is not paid either by the due date or within the days of grace if any. Insurers however are not legally bound to send such reminders or to notify the insured that forfeiture or other consequences will follow²⁵.

In determining the effect of the non-payment of premium on a policy, it is crucial to distinguish between a

24. Stuart v Freeman [1903] 1 KB 47 at p.55.

25. Windus v Tredegar (1866) 15 LT (NS) 108.

contract of life insurance and a contract of non-life insurance. A life policy involves a single contract entered into at the inception of the policy which continues to exist until either the death of the life insured or the attainment by him of a specified age, subject to the payment of the premiums whenever they are due. In non-life policies, the contract is usually for a period of one year. After this period, the contract comes to a natural end and there is no obligation on either party to renew or upon renewal, not to impose new terms and conditions or to charge a different premium. As every renewal of a non-life policy amounts to the making of a fresh contract, the effect of the non-payment of a subsequent premium in a non-life policy amounts to a failure to enter into a fresh contract of insurance.

The legal effect of the non-payment of the subsequent premiums on a life policy depends upon the length of time within which the policy has been in force. Under the Insurance Act, a life policy which has been in force for three years or more shall not lapse or be forfeited by reason of the non-payment of premiums²⁶. Instead the policy shall continue to have effect subject to such

26. s.43(2).

modifications to the period for which it is to be in force or the benefits receivable thereunder or both, as may be determined in accordance with the system adopted by the insurer for the particular type of policy. The insurer is free to adopt any system in making such a modification provided it is one that has the approval of the Director-General of Insurance and is a system which has been adopted and applied at the time the policy in question was issued²⁷.

There are at least three systems of modifying a life policy which are commonly adopted by Malaysian insurers²⁸. The first automatically converts a policy into a fully paid-up policy of such a reduced amount as is determined by the surrender value of the policy. The second involves the grant of a loan by the insurer to the policyholder, for an amount which is equal to the amount of the premium due, to meet the unpaid premium. This can be continued until such time when the loans for the unpaid premiums exceed the cash value of the policy, after which time the policy is forfeited. The third system is one whereby the insurer grants a loan to pay the premium only up to the amount which is needed to

27. s.43(2).

28. Lee, KK, Life Insurance in Malaysia, Life Insurance Association of Malaysia, Kuala Lumpur 1985, pp.116 - 117.

convert the policy to one which is based on a Term Assurance²⁹ for which the premium is much less than that for either a whole life or an endowment policy.

A life policy which has not been in force for the statutory minimum period of three years for it to attain a surrender value will lapse when the premium due is not paid³⁰. Most policies however contain provisions which allow its reinstatement upon the payment of all arrears of premium together with the interests which has accrued thereon, within a given period.

3.0 Return of Premiums

3.1 The General Rule

Generally, the insured can only be entitled to a return of the premium if the risk insured against has never attached as equity implies a condition that the insurer shall not receive the price of running a risk if he runs none³¹. Thus unless otherwise provided in the policy,

29. A policy which provides maximum protection only for a specified period. The insured sum is only payable if the life insured dies within such period.

30. Lai Ah Heng & Anor. v China Underwriters Ltd. Op. cit footnote 16.

31. Stevenson v Snow 97 ER 808 at p.810, per Lord Mansfield.

there must be a total failure of consideration before the insured can be entitled to a return of the premium. Once part of the risk has attached, there is no right to a return of premium as there can be no restitutionary claim for return of money for partial failure of consideration³². In practice however, return of premium for partial failure of consideration is sometimes done either in accordance with the terms of the policy or on an ex gratia basis.

Under the Insurance Act, when a premium for a non-life policy has to be returned, it must be paid directly by the insurer to the insured and the former must obtain a proper receipt from the latter. Under no circumstances must such a return of premium be made through an intermediary³³.

3.2 Where there is no contract or where the risk has never attached

There is a total failure of consideration and therefore a right to a return of premium if the contract of insurance itself is not valid, for instance where it is vitiated by a fundamental mistake, or where the parties were never ad

32. Goff and Jones, The Law of Restitution, 3rd Ed., Sweet and Maxwell, London 1986, pp.54 - 55.

33. s.14A(5).

idem or where the contract is made ultra vires the powers of the insurer. Similarly, the risk does not attach and there is a right to a return of premium where the subject matter is non-existent³⁴ or where either party fails to fulfil a condition precedent to the validity of the contract.

3.3 Where a voidable policy is avoided ab initio by the insurer

Unlike in other contracts, in a contract of insurance no distinction is drawn between the rescission or avoidance of a contract for misrepresentation and breach of contract by virtue of the breach of an affirmative warranty. In both instances, a contract of insurance once avoided is deemed to have been avoided ab initio. Hence unless the insured is guilty of fraud or the policy provides for the forfeiture of premiums, the insured is entitled to a return of the premium when the insurer avoids the contract ab initio either on the grounds of non-disclosure, misrepresentation or breach of an affirmative warranty³⁵. There can however be no return of premium if the non-disclosure, misrepresentation or

34. Such as when the life insured had died before the contract of insurance was entered into; Pritchard Merchants' and Tradesmen's Mutual Life Assurance Society 140 ER 885 at p.894.

35. Thompson v Weems (1884) 9 App. Cas. 671 at p.682 (HL).

breach of warranty is not innocent, ie. if it is tainted with fraud as the rule is that an insurer is never bound to return the premium when they successfully defend an action on the grounds of fraud³⁶.

S.65 of the Contracts Act 1965 provides that where a person at whose option a contract is voidable rescinds it, the other party need not perform his part of the bargain and the party rescinding the contract shall, if he had received any benefits thereunder from the other party, restore such benefits as far as may be to the other party. While this provision seems wide enough to allow a party who had committed fraud to take an action against the party rescinding the contract for money had and received, it has not been considered in relation to contracts of insurance in Malaysia. The Supreme Court of India in dealing with a similar provision however held that an insured who had committed a fraud on the insurer cannot rely upon such a provision to recover the premium which he has paid³⁷.

3.4 Contracts Tainted with Illegality

The right to a return of premium is subject to the

36. Joel v Law Union & Insurance Co. [1908] 2 KB 431 at p.440 and Anderson v Thornton 155 ER 1415.

37. Mithoolal Nayak v Life Insurance Corp. of India AIR (1962) SC 814. S.65 of the Indian Contracts Act 1872 is in pari materia with s.65 of the Malaysian Act.

overriding principle that there can be no such return where the contract is tainted with illegality and the parties are in pari delicto³⁸. This is because a court of law will not have anything to do with such a contract and any loss occasioned thereby lies where it falls. A contract of insurance is illegal if it contravenes certain statutory requirements such as those relating to insurable interest³⁹.

An insured is entitled to a return of the premium paid under an illegal contract if he is not in pari delicto with the insurer. Although literally this means he is not equally blameworthy, the cases decided so far seem to show that an insured is only entitled to a return of premium if he is completely blameless⁴⁰. It remains to be seen if an insured who is less blameworthy than the insurer but not completely blameless, is entitled to a return of the premium on the grounds of illegality.

4.0 Forfeiture of Premiums

The rules relating to the return of premium are all subject to the terms of the policy which can, and often

38. Howard v Refuge Friendly Society (1886) 54 LT 644.

39. Harse v Pearl Life Assurance Co. [1904] 1 KB 588.

40. See eg. British Workmen's and General Insurance Co. v Cunliffe (1902) 18 TLR 502.

do, provide for the forfeiture of premiums in certain instances such as when the policy is avoided for the breach of an affirmative warranty. Strangely, the courts in declaring the policy void ab initio for the breach of such a warranty have upheld and given effect to the forfeiture clauses in such 'non-existent' policies. The courts have upheld such forfeiture clauses not only on premiums paid upon entry into the contract but also on premiums paid after a right to avoid the contract became available to the insurer. In Sparenborg v Edinburgh Life Assurance Co.⁴¹ for instance, a life policy provided that it would be void if the life insured travelled beyond certain prescribed geographical limits. After the policy had been in force for three years, the life insured travelled to India in breach of the said clause. Thereafter he continued paying premiums for fourteen years. The insurer successfully avoided the policy for breach of warranty and the court allowed them to forfeit the entire premium. The approach taken by the court in this case has been justified⁴² on the ground that while avoidance of a policy on the grounds of non-disclosure stricto sensu prevents the insurer from relying upon any

41. [1912] 1 KB 195. See also Kumar v Life Insurance Corporation of India [1974] 1 Lloyd's Rep. 147 where the premium was returned on an ex gratia basis when the policy was avoided for non-fraudulent but incorrect answers in the proposal form.

42. Birds, p.134.

of the terms of the contract, including the forfeiture clause if any, avoidance of a policy for breach of a warranty does not have the same result as the insurer in such an instance is relying upon the terms of the contract to avoid it and they can therefore also rely on any forfeiture clauses therein. This line of distinction however seems academic. Often policies are avoided for a misstatement either in the form of non-disclosure or a misrepresentation in a proposal form which inevitably contains a 'basis of contract' clause which gives the status of a warranty to all the statements therein. Avoidance of a policy for such a misstatement therefore amounts to avoidance for breach of warranty. A policy can only be avoided on the grounds of non-disclosure stricto sensu if there is a breach of the residual duty of disclosure. Given the detailed and extensive questions in the proposal form, such a situation does not arise often.

CHAPTER SEVEN

INTERMEDIARIES

1.0 Introduction

In Malaysia intermediaries form the lifeline upon which the entire insurance industry depends¹. Several factors account for the particularly important role played by them.

Demographically, a large proportion of Malaysia's population is rural. Although there is demand, particularly for third party insurance, from the rural populace, few insurance companies find it economically viable to set up branch offices away from the main town centres. These companies inevitably depend upon intermediaries to 'sell' insurance in the rural areas.

The comparatively high percentage of illiteracy coupled with an even higher percentage of those who do not understand English which is still the main language

1. In 1986 there were a total of 57 registered brokers and 46,973 life agents in Malaysia. The number of non-life agents is not known. 24th Annual Report of the Director-General of Insurance 1986, Ministry of Finance, Kuala Lumpur 1987, p.12.

used in insurance-related documents² make the public regard the services of an intermediary as indispensable.

With increasing competition within the industry, insurers also regard intermediaries as necessary tools for marketing insurance; for in Malaysia, with the exception of compulsory third party insurance, policies are sold, not bought. Intermediaries are hence regarded by the insurers as vital for providing the personal touch and often the extra pressure, in marketing insurance.

1.1 Insurance Agents and Insurance Brokers Distinguished

Generally an agent is a person employed to do any act for another or to represent another in dealings with third persons³. An insurance agent is a person who carries on insurance business as an agent⁴. His main function is to procure persons to enter into contracts of insurance with the insurer, for whom he is basically the agent. The

2. S.16(1) of the Insurance Act 1963 provides that such documents can be in any language provided that if they are not in Bahasa Malaysia (Malay) or English, a translation in either of these languages must be included. Thus when English is used no translation in Malay or any other languages is necessary.
3. Contracts Act 1950 (Revised 1974), s.135.
4. Insurance Act 1963, s.20A(1)(a).

relationship between the agent and the insurer is an on-going one. It does not come to an end after the successful procurement of a particular policy.

Insurance agents in Malaysia fall into three categories. First there are the full-time agents who are employed by the insurance companies to get business for the company and are remunerated by the company by means of commissions. Then there are the occasional or part-time agents whose main occupation is in another field, such as solicitors, estate and travel agents and car dealers, for whom the procurement of insurance policies is incidental to their main occupation. Finally there are the independent agents who are full-time agents but function independently and are not employees of any insurer.

The full-time agents are popular with life companies. Most such companies have an Agency Department which employs, trains and supervises agents in their activities and pay their commissions. Occasional and independent agents deal mainly with non-life policies.

An insurance broker is any individual, firm or company, who for compensation as an independent contractor, solicits, negotiates or procures insurance or the renewal or continuance thereof on behalf of the insured, other

than himself⁵. He acts upon the instructions of his client, the insured, in placing insurance. As his basic agency relationship is with the insured it is on the insured's authority that he acts and to the insured that he owes a duty of skill and care. The broker is usually free to choose from a variety of insurers, with whom he wishes to arrange insurance cover on behalf of his client. Unlike the relationship between the agent and the insurer which is an on-going one, that between a broker and a particular insured who procures his services, is usually for a single identifiable transaction and ceases once this purpose is served. Although a broker is generally the insured's agent, he is usually remunerated by the insurer from whom he obtains insurance cover for his client, on a commission basis.

An insurance intermediary is a person who invites another to make an offer or a proposal or to take any other step with a view to entering into a contract of insurance⁶. The term intermediary thus includes both insurance agents and brokers.

The Insurance Act requires a person who invites another to make an offer or proposal or to take any other step

5. Insurance Act 1963, s.1A

6. s.20A(1)(a).

with a view to entering into a contract of insurance with an insurer to inform that person about his (the intermediary's) connection with the insurer⁷. While this provision has a lot of potential, the realisation of such potential depends to a large extent on how this provision is construed and how the authorities respond to complaints from the consumers about its breach. If this provision requires the intermediary to do no more than inform a potential insured whether he is an agent or a broker, little purpose can be served as such information means little to one who is not aware of the legal distinction between the two. To be effective this provision must be interpreted as requiring the intermediary not only to inform a potential insured whether he is an agent or a broker but also to explain the significance and legal implications of being either of them. For instance, that a broker is for the purposes of procuring a policy an agent of the insured and so disclosure to him does not amount to disclosure to the insurer. Furthermore the effectiveness of this provision also depends on the degree of public awareness as to its existence. Action can only be taken against intermediaries who fail to comply with this provision if the public complains to the Director-General of Insurance. Without being aware of this provision the

7. s.20A.

public cannot do so.

1.2 An Outline of the General Law of Agency

As an insurance agent basically has an agency relationship with the insurer while the broker basically has such a relationship with the insured, the general law of agency is applicable to both. In Malaysia this is found in Part X of the Contracts Act 1950.

Anyone of the age of majority can become an agent and be responsible to his principal in accordance with the provisions of the Act⁸. The agent's authority can be expressed or implied⁹. An agent who is authorised to do an act has the authority to do every lawful act necessary for that purpose while one who has authority to carry out a business has authority to do every lawful thing necessary for that purpose or usually done in the course of conducting such business¹⁰.

An agent must act within the scope of his authority which can be either actual or apparent. Actual authority can be expressed, either orally or in writing, or implied from custom or the usual course of business. Apparent authority is the authority which the agent appears to

8. Contracts Act 1950, s.138.

9. s.139.

10. s.141(1) and (2).

have in the eyes of a third party and may be greater or wider than the agent's actual authority. Any act which is in excess of the agent's authority can be ratified by the principal¹¹. In the absence of such ratification a principal is not bound by the unauthorised acts of the agent¹².

An agent is legally bound to conduct the business of his principal according to the direction given by the principal¹³, and to use as much skill and diligence as is generally possessed by persons engaged in similar business¹⁴. Notice given to or obtained by an agent in the course of the principal's business binds the principal¹⁵. Similarly, any misrepresentation or fraud committed by the agent in the course of the principal's business shall have the same effect as if the misrepresentation or fraud had been committed by the principal¹⁶.

The application of the provisions in the Contracts Act to insurance intermediaries does not make the common law principles totally irrelevant. The provisions of Part X

- 11. s.149.
- 12. s.180 and s.181.
- 13. s.164.
- 14. s.165.
- 15. s.182.
- 16. s.191.

of the Contracts Act are not exhaustive and there are various aspects of agency about which the Act is silent. Where a situation arises which is not provided for by Part X, the trend of judicial opinion seems to favour the application of the common law¹⁷.

2.0 Insurance Agents

2.1 The Agent's Authority

As mentioned earlier an insurance agent is generally an agent of the insurer. Agents who are employed by an insurance company usually derive their authority from the agency contract between them and the company. This document normally stipulates the terms and conditions of the agency as well as the general scope of the agent's authority. Other types of agents may derive their authority from the insurer either verbally, by an exchange of correspondence or impliedly from the usual

17. For instance the Act is silent about del credere agents but in Royal Insurance Group v David [1976] 1 MLJ 128, this concept was recognised, see infra. p.284. This approach of applying the common law to fill in the gaps in the statute contrasts remarkably from the approach taken in some other cases. In Ramjida v Abdul Kadir (1915) 2 FMSLR 158, it was held that as provisions relating to bailment were found in the Contracts Enactment 1896, the common law relating to common carriers could not be applied even though the Enactment was silent on this. In Song Bok Yoong v Ho Kim Poui [1968] 1 MLJ 56, a similar decision was reached in relation to guarantees.

course of business. Sometimes it cannot be determined solely by looking at the source of the agent's authority whether a particular act is within the scope of the agent's authority. In such a situation the specific act together with the facts surrounding it will have to be looked at.

2.1.1 Soliciting and Negotiating a Contract of Insurance

Where an agent has the authority to solicit and negotiate a contract of insurance on behalf of the insurer, any representation made by the agent within the scope of such authority binds the insurer. Similarly any information acquired by the agent during this pre-contract stage is information acquired by the insurer irrespective of whether or not the agent conveys the information to the insurer.

In Mazzarol v United Oriental Assurance Sdn. Bhd. (Kuantan)¹⁸, a vessel, The Melanie, was insured by the plaintiff with the defendant. Just before the insurance was procured the vessel had grounded. She was subsequently pulled clear and anchored at a jetty, before the cover was arranged. In obtaining the insurance cover, the plaintiff contacted Pany, the defendant's full-time

18. [1983] 1 MLJ 328 (HC) and [1984] 1 MLJ 260 (FC).

agent. The fact of the earlier grounding was told to Pany but was not disclosed in the proposal form which Pany had helped to fill in as there was no question to that effect. Pany also inspected the vessel at the jetty.

Two weeks after the cover was obtained the plaintiff took the vessel out to sea where it hit a sand bar and was damaged. The defendant denied liability because of the non-disclosure of the fact that the vessel had grounded before. It was held that there was no non-disclosure because this information had been disclosed to the agent and this amounted to a disclosure to the insurer.

In upholding the decision of the High Court, the Federal Court distinguished between the stage when the agent negotiated the contract and the stage when he helped the insured to fill in the proposal form. According to Salleh Abas CJ (as he then was):¹⁹

Whilst we agree that Pany must be regarded as an agent for the [insured] in so far as he assisted the former in completing the proposal form - see Newsholme Brothers v Road Transport and General Insurance Co. Ltd. [1929] 2 KB 356 - we think that the learned trial judge was correct in holding that Pany was not acting as an agent of the [insured] when he received information about the earlier mishap ... from the [insured]. The capacity in which he received the verbal information must be the same as the capacity in which he went to see

19. [1984] 1 MLJ 260 at p.262.

the [insured] with the proposal form, gave it to him, receive it back from him, inspected the 'Melanie' and handed the form to his branch office. All these acts except the tendering of advice as to how to fill the proposal form were done in his capacity as an agent of the [insurer].

Since the negotiation for cover, the tendering of advice and the actual filling in of the proposal form took place on two separate occasions, it was easy for the Federal Court to draw a distinction between information acquired by the agent in the course of the negotiation and that obtained whilst advising the insured about, and helping him to fill in, the proposal form. If the two had taken place on one occasion as is extremely common in cases like motor insurance, it will be difficult to determine when negotiation ends and the tendering of advice and the actual filling in of the proposal form, begins.

Interestingly, neither the High Court nor the Federal Court seemed to have given any weight to the fact that the agent had personally inspected the vessel. It is not clear from the facts whether the vessel had any visible evidence of the earlier grounding but if there was such evidence, than this could also be used to effectively distinguish this case from Newsholme Brothers v Road Transport and General Insurance Co.²⁰, and to align it

20. [1929] 3 KB 356.

with the decision in Bawden v London, Edinburgh and Glasgow Assurance Co.²¹.

No reference was made by either of the courts to s.182 of the Contracts Act relating to imputed notice. Once it is accepted that an agent has the authority to solicit and negotiate a contract of insurance, any information obtained by the agent in the course of such negotiation must have the same legal consequence as if it had been obtained by the principal. While this provision is inapplicable when an agent acquires such information when he is not acting as the insurer's agent (such as in filling in the proposal form) it was clearly applicable in this case as the information was acquired by the insurer's agent in such capacity.

2.1.2 Filling in Proposal Forms

In England, the general rule according to the Court of Appeal in Newsholme Brothers is that an insurance agent in completing the proposal form is the amanuensis of the insured and so any information acquired by him in doing so cannot be imputed to the insurer. In this case the proposal form was filled in by the insurer's agent although he had no authority to do so. In spite of being

21. [1892] 2 QB 534. See infra. p.254.

given the correct answer by the insured, the agent wrote down an incorrect answer in the proposal form which was then signed by the insured. The insurer sought to avoid the policy on the basis of the incorrect answer. The insured contended that as the correct information was known by the agent, it could be imputed to the insurer. It was held that the insurer could avoid the policy as information acquired by the agent when filling in the proposal form could not be imputed to the insurer as in so doing the agent was not acting as the insurer's agent.

This general rule however does not apply when the information was acquired by the agent prior to filling in the proposal form, particularly when such information was evident irrespective of any representation by the insured, or where information was acquired by the agent when filling in the proposal form but in doing so he was acting within the scope of his authority as the insurer's agent. These were among the factors used by the Court of Appeal in Newsholme Brothers to distinguish the facts in that case from those in the earlier Court of Appeal case of Bawden. Bawden, an illiterate who had lost the use of one eye, had a policy issued by the defendant. The proposal form contained a declaration that he had no physical infirmity which rendered him particularly liable to accidents and was filled in by a local agent of the defendant. It was also not mentioned in the proposal form that Bawden had only one eye. It was held that the

agent's knowledge was the knowledge of the insurer and so the insurer must be taken to have contracted with a man whom they knew had only one eye.

Another landmark English decision is Stone v Reliance Mutual Insurance Society²². The plaintiff had fire policies issued by the defendant which had lapsed for non-payment of premiums. An Inspector from the defendant company then persuaded the plaintiff's wife to take out a new policy at a higher premium. The proposal form for this policy was filled in by the Inspector but was signed by the plaintiff's wife. A claim under the new policy was denied by the insurer on the ground that the plaintiff had not disclosed the facts that he had made claims under other policies before and that his earlier policies had lapsed. The proposal form had a declaration to the effect that insofar as any part of the form was not filled in by the insured, it had been done on his instruction and by his agent.

The Court of Appeal's decision in favour of the insured hinged so heavily upon the special facts of the case that Stone like Bawden is generally regarded as an exception to, rather than one that overrules, Newsholme Brothers²³.

22. [1972] 1 Lloyd's Rep. 469.

23. Birds, pp.124 - 125.

The trend of judicial opinion in Malaysia seems to be along the lines of the the Court of Appeal decision in Newsholme Brothers; the reasons given therein being echoed in the local decisions. In Abu Bakar v Oriental Fire and General Insurance Co. Ltd.²⁴, an attempt was made by the insured's counsel to persuade the Federal Court to accept the decision in Stone as representing a swing back to Bawden. Unfortunately, only Gill FJ in his dissenting judgement gave any thought to this argument. His Lordship however rejected this contention and concluded that Stone represented only an exception to the general rule as laid down in Newsholme Brothers.

The following are among the reasons used by the Malaysian judges to justify their unqualified acceptance of Newsholme Brothers.

(i) That the Proposal Form which had a Basis of Contract Clause was Signed by the Insured

Scrutton LJ in Newsholme Brothers emphasised the fact that the proposal form which had a 'basis of contract' clause was signed by the insured:²⁵

I have great difficulty in understanding how a man who has signed, without reading it, a document which he knows to be a proposal for

24. [1974] 1 MLJ 149.

25. Op. cit. footnote 20 at p.376.

insurance, and which contains statements in fact untrue, and a promise that they are true, and the basis of the contract, can escape from the consequences of his negligence by saying that the person he asked to fill it up for him is the agent of the person to whom the proposal is addressed.

A similar line of reasoning was used by Gill J in United Malayan Insurance Co. Ltd. v Lee Yoon Heng:²⁶

[T]he proposal form ... was completed by [the agent] at the [insured's] request and ... the [insured] signed a declaration at the foot of the proposal form to the effect that the particulars of the proposal form were true and that the proposal shall be the basis of the contract between himself and the [insurer]. I therefore find that the [insured] made an application for insurance and that he completed the proposal form²⁷.

The insurer in this case had sought a declaration that a third party motor policy issued to the insured was void for non-disclosure of the fact that the vehicle was to be used for commercial purposes. The insured contended that this fact was known to the agent who had helped him to fill in the proposal form. The court rejected this contention and granted the declaration.

Gill J in this case seems to have gone a step too far in holding that by signing the proposal form the insured was

26. (1964) 30 MLJ 453 at p.454.

27. Emphasis added.

deemed to have filled in the proposal form himself, as that would have made the question of agency totally irrelevant. The insured's signature does not, it is submitted, have the effect of completely wiping out the part played by the agent in completing the proposal form. Rather, the signature confirms the fact that in filling in the proposal form the agent was acting as the insured's agent; the signature being evidence of adoption or ratification by the insured of the agent's act.

In National Insurance Co. v Joseph²⁸, the insurer claimed that a motor policy issued to the defendant was void for non-disclosure and misrepresentation as the defendant had failed to disclose that his previous policy had been cancelled after he met with an accident. The proposal form which contained the usual 'basis of contract' clause was filled in by the insurer's agent after it had been signed in blank by the defendant. The court decided in favour of the insurer as it was found from the evidence that the information had not even been disclosed to the agent. The learned judge further observed that even if the information had been disclosed to the agent when he was filling in the proposal form, the insurer would still have succeeded because by signing the form, the insured would be taken to have read and adopted its contents.

28. [1973] 2 MLJ 195.

As the insured had declared in the proposal form that the answers given were true it was his duty to ensure that they were in fact true.

A comparable decision was reached in Wong Lang Hung v National Employees' Mutual General Insurance Co.²⁹. The insured's claim under a fire policy was denied by the insurer on the ground that there was a misstatement in the proposal form. The insured replied that the fact allegedly misstated - that the insured premises was attached to another building - was known by the insurer's agent who had helped to fill in the proposal form. According to the evidence, after the agent had filled in the form, the insured took it away to have someone else read it to him. This was used by the learned judge to strengthen his decision which was basically similar to that in Joseph. According to him:³⁰

If a person ... chooses to sign the form without reading the contents of the proposal form which somebody else filled in and takes the form home for someone to read it, and ... acquiesces in that by signing it, she must be taken as having adopted it.

The Malaysian courts have held rigidly to the rule that a person who signs a document is bound by its contents even

29. [1972] 2 MLJ 191.

30. Ibid. at p.195.

in a situation where the proposal form was in English and the insured could neither read, write nor understand the language³¹. This rather harsh approach seems consonant with local decisions in other areas of the law³². A similar approach was also adopted by the Supreme Court of New South Wales in Jumna Khan v Bankers and Traders Insurance Co.³³ where Street CJ said:³⁴

[The insured's] illiteracy did not in any way relieve him from the duty of taking every reasonable means that he could to ascertain what his obligations were, and to see that no untrue statements were put before the company. It afforded no excuse for his carelessness and indifference.

The English courts however seem to be more sympathetic towards the illiterate. It is generally accepted that one of the factors which justified the Court of Appeal's decision in favour of the insured in Bawden is the fact that the insured in that case was illiterate³⁵.

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31. United Malayan Insurance Co. Ltd. v Lee Yoon Heng, Op. cit. footnote 26.
32. The principle in L'Estrange v Graucob [1934] 2 KB 394 that a person who signs a document which contains contractual terms is generally bound by such terms even though he has not read them and is ignorant of their precise legal effect was applied in Serangoon Estates Ltd. v Marian Chye (1959) 25 MLJ 113. In Subramaniam v Retnam [1966] 1 MLJ 172, it was held that even if the person could not read the language in which the document was written, the same principle would still apply.
33. (1925) 37 CLR 451.
34. Ibid. at p.454.
35. See eg. Greer LJ in Newsholme Brothers, Op. cit. footnote 20 at p.381, Birds, p.123 at footnote 43 and MacGillivray, p.352, at paras. 843 - 844.

Perhaps one way of persuading the courts to take cognisance of the insured's illiteracy is by pleading non est factum. Although not provided by the Contracts Act 1950, this plea is recognised in Malaysia³⁶. It has not however been used in any of the reported cases involving proposal forms or other contractual documents in insurance.

(ii) The Insurer's Agent in Filling in the Proposal Form Acted in Excess of his Authority

The other justification used by the Court of Appeal in Newsholme Brothers was that in filling in the proposal form the agent was acting outside the scope of his authority as the insurer's agent. An act done by an agent without the principal's authority cannot be imputed to the principal in the absence of ratification by the principal. Whether an agent is authorised by the insurer to fill in the proposal form is not always easy to determine. Though the agency agreement or other communications creating the agency may be silent on this issue, an agent may still have an implied or an ostensible authority to do so, such as in a situation where the insurer is aware that the agent habitually fills in the proposal form and yet takes no positive

36. Awang bin Omar v Haji Omar and Anor. (1948-49) MLJ (Sunn.) 28.

steps to prevent or prohibit such a practice.

The agent's authority to fill in the proposal form as the insurer's agent can also be implied if there is close consultation between the agent and the insurer at the time when the proposal form was being filled in by him. This was used by Suffian FJ (as he then was) in his dissenting judgement in China Insurance Co. Ltd. v Ngau Ah Kau³⁷ to get around the decision in Newsholme Brothers. According to his Lordship:³⁸

[B]ecause of the close consultation between the [agent] and [the insurer's manager] at the time when the form was being filled, it was quite proper for the learned judge to find ... that [the agent] was also the company's agent and that accordingly, [the agent's] knowledge can be imputed to the company.

If an agent is authorised by the insurer to fill in the proposal form, he still acts in excess of that authority if he commits a fraud on the insurer by deliberately giving false answers in the form; his knowledge of the true information cannot in such a case be imputed to the insurer. This was emphasised by Yong J in National Insurance Co. v Joseph:³⁹

37. [1972] 1 MLJ 52.

38. Ibid. at p.56.

39. Op. cit. footnote 28 at p.196.

[If] the agent completes [the proposal form] with false and untrue material particulars for the purpose of getting a policy for the applicant and a commission for himself in fraud of his principal, the agent is not acting within the scope of his authority and in so doing he is not acting as the agent of the insurance company and the latter with no knowledge of such fraud is entitled to avoid the policy.

If the agent fills in the proposal form at the request of the insured, then clearly he does so as the insured's agent. The insured is thus responsible for the entire contents of the form; the fact that he had not authorised the agent to give false answers being irrelevant. In Ong Eng Chai v China Insurance Co. Ltd.⁴⁰, the insured's claim under a policy was rejected by the insurer because the proposal form contained untrue answers relating to the insured's insurance history. The insured contended that the form was filled in and signed by the insurer's agent who knew the true information. According to the evidence the insured had left the entire question of effecting the policy with the insurer's agent and sub-agent. It was held that as the insured had authorised the agent to effect the insurance and to fill in the proposal form, he himself was responsible for the untrue answers therein, irrespective of his knowledge of the agent's fraud.

40. [1974] 1 MLJ 82.

Insurers frequently include in the proposal form a declaration by the insured that if the form had been filled in by someone else it was done with the insured's authority and as his agent. If such a declaration is given literal effect, it would make anyone who fills in the proposal form, including the insurer's agent, an agent of the insured. In Stone v Reliance Mutual Insurance Society⁴¹, there was such a declaration in the proposal form but Lord Denning was of the view that the insurer was not entitled to rely upon it because their agent had misrepresented to the insured that the form had been correctly filled in.

In Malaysia the status of a similar clause was considered in Pacific and Orient Insurance Co. v Choo Lye Hock⁴² and the Malaysian court too did not allow the insurer to rely upon it, albeit for a different reason. According to Abdul Hamid J:⁴³

To my mind the declaration only raises a rebuttable presumption. It may be rebutted by extraneous evidence and the onus lies upon the [insured] ... the fact that [the agent's] name appears at the top of the proposal form against the word 'Agency' provides clear proof that he was the agent of the [insurer] and not of the [insured].

41. Op. cit. footnote 22.

42. [1977] 1 MLJ 131.

43. Ibid. at p.132.

In accepting the word 'Agency' which appeared against the agent's name at the top of the proposal form as sufficient to negate the effect of an express declaration, the learned judge seems to have made a desperate attempt to avoid the decision in Newsholme Brothers. Today it is a common practice particularly among large insurance companies to have the agent's name on the proposal form not for any legal reason but so as to enable easy identification of the agent involved in a particular transaction.

(iii) The Parole Evidence Rule

The parole evidence rule, ie. the inadmissability of oral evidence to contradict the terms of a written contract, was also used to justify the decision in Newsholme Brothers. According to Greer LJ:⁴⁴

Once a contract is reduced into writing, the writing alone can be looked at as containing the terms of the contract. Anything said during the negotiations ceases to have any legal validity.

In Malaysia, provisions relating to the parole evidence rule are found in the Evidence Act 1950:

s.91 When the terms of a contract ... have been reduced ... to the form of a document, no

44. Op. cit. footnote 20 at p.379.

evidence shall be given in proof of the terms of such contract except the document itself.

s.92 When the terms of any such contract have been proved according to section 91, no evidence of any oral agreement or statement will be admitted ... for the purpose of contradicting, varying, adding to or subtracting from, its terms.

The Federal Court used the above provisions in relation to proposal forms in China Insurance Co. Ltd v Ngau Ah Kau⁴⁵. A claim by the insured was rejected by the insurer because of a misstatement in the proposal form. The insured contended that he had given the correct information to the insurer's agent but was told that it was unnecessary to include them in the proposal form. The agent gave evidence which corroborated this claim and the trial judge decided in the insured's favour inter alia on the ground that as the agent had acted throughout on the insurer's behalf his knowledge could be imputed to the insurer⁴⁶.

This decision was reversed by the Federal Court. One of the reasons given was that the oral evidence given by the agent was inadmissible by virtue of sections 91 and 92 of the Evidence Act. According to Azmi LP, as the truth of the statements and answers in the proposal form had been

45. Op. cit. footnote 37.

46. For the High Court decision see Ngau Ah Kau v China Insurance Co. Ltd. (1970) 4 MC 122.

made terms of the contract, it was, by reason of those provisions, not open to the insured to make use of the oral evidence of the agent to contradict, vary, add to or subtract from, such terms.

Suffian FJ (as he then was), in his dissenting judgement however was of the view that these provisions were inapplicable. His Lordship distinguished between the terms of a written contract and the answers in a proposal form and held that sections 91 and 92 were only applicable to the former. Accordingly:⁴⁷

The [insured] admits in toto the terms of the proposal form and the policy, and accordingly there is no question of contradicting, varying, adding to or subtracting from its terms; all he tried to do was to contradict the written answers in the proposal form. For this reason in my judgement sections 91 and 92 have no application.

Unless the proposal form can be regarded as a document which is independent of and different from, the contractual document which alone contains the terms of the contract, it is difficult to comprehend how answers to questions in the proposal form can be regarded as anything other than the terms of the contract. This is particularly so as the proposal form contains a 'basis of contract' clause.

47. Op. cit. footnote 37 at p.36.

In Pacific and Orient Insurance Co. v Choo Lye Hock⁴⁸, the High Court referred to the words used in the 'basis of contract' clause in the proposal form to avoid sections 91 and 92 of the Evidence Act. The clause included a declaration by the insured that the 'answers' given therein were true and correct and would be the basis of the contract. Abdul Hamid J was able to avoid the Federal Court decision in Ngau Ah Kau in relation to sections 91 and 92 by arguing that in the case before him only 'answers' in the proposal form were made terms of the contract. As the incorrect information about the insured's address and occupation were not given as answers to any question, they were not terms of the contract and therefore the provisions relating to parole evidence did not apply.

The meaning given to the word 'answers' in this case is unduly restrictive and not entirely accurate. An answer need not necessarily be a response to a question only. If the words 'Address and Occupation' appear in the proposal form and the space next to them is left blank to be filled in by the insured, what is then written in is surely as much an answer as is a response to the question 'What is your address and occupation?'⁴⁹

48. Op. cit. footnote 42.

49. See also Poh, CC, 'The Insurance Agent and the Insured', [1986] 1 MLJ xliii.

Even if the learned judge was correct in giving such a narrow meaning to the word 'answers', his decision is unlikely to have any long-lasting positive implication for the insured. The effect of the decision can easily be neutralised by the insurers specifically making both 'answers' and 'statements' in the proposal form, terms of the contract.

There are however two possible ways by which the provisions of sections 91 and 92 of the Evidence Act can be avoided.

The proviso to s.92 provides for six different situations where oral evidence may be admissible. Of these, only proviso (a) may have some relevance to proposal forms. It reads:

Any fact may be proved which would invalidate any document or which would entitle any person to any decree or order relating thereto, such as fraud, intimidation, illegality, want of due execution, want of capacity in any contracting party, the fact that it is wrongly dated, want or failure of consideration or mistake of fact or law.

If an insured is made to believe by the agent who helps him to fill in the proposal form, that a particular piece of information has been included when this is not in fact so, oral evidence can thereafter be adduced to have the said proposal form invalidated on the ground of fraud or

rectified on the ground of mistake of fact.

Furthermore, the proviso aside, s.92 only prohibits the adducing of oral evidence to contradict, vary, add to or subtract from the terms of a written document. Evidence can therefore be adduced to show that a breach of a term of the contract has been waived by the other party as such evidence of a waiver does not in any way challenge the terms of a written document. It is unfortunate that this line of argument which could have been successfully used was not utilised in his dissenting judgement by Suffian FJ in Ngau Ah Kau to support the finding that sections 91 and 92 were inapplicable. It could have been argued that in adducing evidence to show that the true facts were known to the agent, the insured was attempting to prove that the insurer had waived the breach of a term in the proposal form and was not challenging the term itself.

2.1.3 Statutory Provisions Relating to Information Acquired by Agents at the Pre-Contract Stage: Sections 18E and 44A of the Insurance Act 1963

Prior to 1975 the Insurance Act did not have any provision relating to agents soliciting and negotiating a contract of insurance or filling in the proposal form. The law till then was the common law as applied in the cases considered earlier. The Insurance Amendment Act

1975⁵⁰ introduced a limited change by the introduction of s.18E, a provision which relates exclusively to agents filling in a proposal form for a home-service policy⁵¹. It reads:

Where an agent or servant of an insurer fills in or writes in any particulars in a proposal for a home-service policy with the insurer, then notwithstanding any agreement to the contrary between the proposer and the insurer, any policy issued in pursuance of the proposal shall not be avoided by reason only of any incorrect or untrue statement contained in any such particulars so written or filled unless the incorrect or untrue statement was in fact made by the proposer to the agent or servant for the purposes of the proposal.

This provision has not made any impact on the development of insurance law in Malaysia as it does not effectively change the law as represented by the Newsholme Brothers line of cases. The basic problem with this provision is its opening phrase - it refers to 'an agent or servant of the insurer' who fills in the proposal form while according to Newsholme Brothers an agent who does so is not the agent of the insurer but is the agent of the insured. This provision does not therefore prevent an insurer from raising the same defence as that raised in

50. Act A294 of 1975.

51. Defined in the First Schedule of the Insurance Act as 'a life policy in respect of which premiums are contracted to be paid at intervals of less than two months and are or have been ordinarily collected in the course of door-to-door collection'.

Newsholme Brothers, ie. that as the agent was not authorised by the insurer to fill in the proposal form, in doing so he was not the insurer's agent but that of the insured.

The problems posed by s.18E were resolved by the introduction of s.44A by the Insurance Amendment Act 1979⁵². This provision which applies to all branches of insurance was borrowed from the recommendations of the English Law Reform Commission⁵³ which were made more than two decades earlier but have yet to become law in England. Section 44A reads:

Knowledge and statement by authorised agent to be deemed knowledge and statement by insurer.

(1) A person who has at any time been authorised as its agent by an insurer and who solicits and negotiates a contract of insurance in such a capacity shall in every such instance be deemed for the purpose of the formation of the contract to be the agent of the insurer and the knowledge of such person relating to any matter relevant to the acceptance of the risk by the insurer shall be deemed to be the knowledge of the insurer.

(2) Any statement made or any act done by such person in his representative capacity shall be deemed, for the purpose of the formation of the contract, to be a statement made or act done by the insurer notwithstanding any contravention of section 16A or any other provision of this

52. Act A465 of 1979.

53. The Law Commission, Conditions and Exceptions in Insurance Policies, Cmnd.62, HMSO, London 1957, para.14.

Act by any such person.

- (3) This section shall not apply -
- (a) where there is collusion or connivance between such person and the proposer in the formation of the contract, or
 - (b) where such person has ceased being its agent and the insurer has taken all reasonable steps to inform or bring to the knowledge of potential policyowners and the public in general the fact of such cessation.

Section 44A solved the problems posed by s.18E. While s.18E refers to 'an agent or servant of the insurer', the opening phrase in s.44A refers to 'any person who has at any time been authorised as its agent by an insurer' and deems such person to be the agent of the insurer for the purpose of the formation of the contract. Thus all an insured is required to prove under s.44A is that the person he was dealing with has at any time been the agent of the insurer.

Section 44A is much wider in its scope than s.18E. Whilst the former applies exclusively to home-service policies, s.44A is applicable across the board. Furthermore, while s.18E deals with the specific act of the agent in filling in the proposal form, s.44A covers the broad spectrum of time from the stage when the agent solicits and negotiates a contract of insurance, fills in the proposal form and completes the contract, ie. the entire pre-contract stage. However the inclusion of the stage

where the agent solicits and negotiates the contract in s.44A does not seem to alter in any way the existing law in this respect. It is clear from the English case of Bawden v London, Edinburgh and Glasgow Insurance Co.⁵⁴ and from the Malaysian case of Mazzarol v United Oriental Insurance Co. Sdn. Bhd.⁵⁵ that even prior to the introduction of s.44A, information acquired by the agent at the time when he solicits and negotiates a contract of insurance is deemed to be information acquired by the insurer, the agent being at such time the insurer's agent.

While there is a 'no contracting out' clause in s.18E, s.44A is silent on this issue. However it seems clear from the nature of the provision that parties to an insurance contract cannot contract out of s.44A. Being a 'deeming' provision, s.44A cannot be contracted out of even in the absence of an express prohibition to that effect. Furthermore the very reason for the introduction of this provision is the protection of the insured, the weaker of the two parties in an insurance contract. Such being the case, the principle enunciated in Johnson v

54. Op. cit. footnote 21.

55. Op. cit. footnote 18.

Moreton⁵⁶ and endorsed by the Federal Court of Malaysia in SEA Housing Sdn. Bhd. v Lee Poh Choo⁵⁷ ie. that in an Act where the weaker party is the subject of protection, even in the absence of specific language to that effect, the court will not allow contracting out unless it is in favour of the weaker party, will apply.

Section 44A has also to a certain extent resolved the problem posed by the 'basis of contract' clause and the decision in Dawsons v Bonnin⁵⁸. The reference to the knowledge of the agent 'relating to any matter relevant to the acceptance of the risk by the insurer' includes both cases of non-disclosure and breach of warranty. While non-disclosure relates only to material facts, according to the decision in Dawsons v Bonnin, the effect of the 'basis of contract' clause is to make every answer in the proposal form though immaterial, relevant. By referring to relevancy rather than materiality, s.44A covers not just the agent's knowledge of material facts but also of other facts made relevant by the 'basis of contract' clause.

Section 44A(2) places the responsibility for false, deceptive or misleading statements made by the agents,

56. [1978] 3 All ER 37.

57. [1982] 2 MLJ 31. See further, Sinnadurai, V, (Ed.) Survey of Malaysian Law 1982, Malayan Law Journal Publishers, Kuala Lumpur 1983, pp.289 - 391.

58. [1922] AC 413.

upon the insurers. This indirectly imposes upon them an obligation to keep a vigilant eye on the activities of their agents and the methods employed by such agents in the marketing of insurance. To avoid being held responsible insurers must ensure that agents with a tendency to deceive or to mislead are quickly and effectively discharged from office. The emphasis placed by sub-section (3)(b) on the need for insurers to make public the cessation of a particular agency, reflects that in introducing this provision the legislature was also keen to ensure that insurers inform the public of the termination of an agency.

A final issue for consideration in relation to s.44A relates to its commencement. The Insurance Amendment Act of 1979 was gazetted in the same year and has since become law. The Act itself however does not give a date for that provision to come into force or give details as to how it should be implemented. The case of Mazzarol v United Oriental Assurance Sdn. Bhd.⁵⁹ was decided after 1979 but neither the High Court nor the Federal Court mentioned s.44A. Presumably this was because the facts in this case arose prior to 1979. Since then the Malaysian judiciary has yet to apply or acknowledge the existence of this important provision. Since s.44A deals

59. Op. cit. footnote 18.

essentially with the formation of a contract of insurance, it should be applied to all such contracts formed after the Amendment Act came into force, for it is a general rule in the interpretation of statutes that all statutes except those relating to evidence or procedure are prima facie prospective⁶⁰.

2.1.4 Granting Temporary Cover

The Insurance Act does not have any provision relating to the granting of temporary cover by agents. Under the common law, the authority of the agent to grant temporary cover does not depend merely upon the existence of real or express authority from the insurer to that effect. Circumstances may show that the agent has either ostensible or implied authority to grant such cover. This is so where the insurer gives to the agent blank cover notes for his use⁶¹ or where the insurer habitually adopts oral contracts providing temporary cover entered into by the agent on their behalf⁶².

In Chop Eng Thye Co. v Malaysia National Insurance Sdn. Bhd.⁶³, the insured claimed a sum of (M)\$20,000 under a temporary protection note allegedly issued by the

60. Halsbury's Laws of England, 4th Ed., Vol. 44, Butterworths, London 1983, p.570, para.922.
61. Mackie v European Assurance Society (1869) 21 LT 102.
62. Murfitt v Royal Insurance Co. (1922) 38 TLR 334.
63. [1977] 1 MLJ 161.

insurer. The insurer denied liability on the ground that the note had been issued by someone who had not been duly appointed as their agent and without their authority.

The insurer's agent, S Co., as was allowed by the agency agreement, appointed the Associated General Corporation (AGC) as their sub-agent. AGC was in possession of the insurer's protection notes, and the protection note in this case was issued to the insured by Lee, an employee of AGC but was signed by AGC's manager. The insurer contended that the purported appointment of Lee by AGC was improper by virtue of the principle delegatus non potest delegare and as such the protection note issued by him was not binding on them. Ajaib Singh J disagreed and held the protection note to be valid. It was issued by Lee not as a 'sub' sub-agent but as an employee of AGC and the note was in fact signed by AGC's manager.

2.1.5 Appointing Sub-Agents

Whether an agent has the authority to delegate his functions to someone else or to appoint sub-agents depends primarily on whether this is allowed by the terms of his agency agreement with the insurer. Where the agreement itself is silent on this issue, an agent can only appoint a sub-agent if it is in the ordinary custom of the trade that sub-agents are appointed, otherwise such an appointment would be in conflict with the

principle delegatus non potest delegare.

A sub-agent cannot appoint a 'sub' sub-agent, but he is free to employ people to work for him and to make them handle, as his employees, work related to the said sub-agency. This is inevitably the case where the sub-agent is not an individual but a firm or a company. In Chop Eng Thye, the insurer's claim that the appointment of Lee by the sub-agent was in conflict of the principle delegatus non potest delegare was rejected by Ajaib Singh J:⁶⁴

[AGC] might not have been in a position to delegate their powers under the sub-agency to another person but I think the appointment of Lee as their insurance agent was not so much in conflict with the maxim delegatus non potest delegare as such but was rather an independent act by [AGC] of employing someone to work for them. It is not unusual for chief agents or sub-agents of insurance companies to employ people who are loosely termed as insurance agents to sell insurance policies and pay commission on policies sold by them.

Once properly appointed, a sub-agent is deemed to be employed by, and acts under the control of, the agent. The sub-agent is therefore responsible to the agent while the agent is responsible to the insurer for the acts and omissions of the sub-agent.

64. Ibid. at p.164.

If the insured deals with a person who fraudulently acts as a sub-agent of the insurer, neither the agent nor the insurer, in the absence of holding out by either of them, is liable to the insured for the acts of the purported sub-agent. In Lee Cheng Oo v China Insurance Co.⁶⁵, the plaintiffs who were timber merchants bought a lorry from Orchard Motors through L, Orchard Motors' assistant manager. L who claimed that he was also a sub-agent of the defendant, offered to help the plaintiffs arrange insurance cover for the lorry. L arranged for such cover through C, the defendant's authorised agent. The plaintiffs paid the premium to L but it was not forwarded by L either to C or to the defendant. It was held that the defendant could effectively cancel the policy for non-payment of premium as payment to L did not amount to payment to them or their agent.

2.1.6 Handling Premiums

One of the functions commonly performed by an agent is the collection of premiums from the insured for transmission to the insurer and occasionally, returning the premium from the insurer to the insured. This function raises the important question of whether an insured discharges his obligation to pay the premium if

65. (1962) 28 MLJ 297.

he pays it to the agent but the agent fails to forward it to the insurer. Conversely, if a premium has to be returned to the insured, has an insurer discharged such an obligation by merely returning it to the agent?

Basically the answers to the above questions depend on whether the agent has the authority to handle the premiums. If the insured alleges that he has paid the premium to an agent who has the authority to receive it on behalf of the insurer, it is for the insured to prove it. Similarly if the insurer relies on the agent's lack of authority in denying liability, then it is for them to prove such lack of authority.

While the Insurance Act 1963 retains the basic common law principle, the onus of proving such authority has been altered. In relation to non-life policies, the Act provides that if any such payment is received by an agent or a broker on behalf of the insurer, receipt of the premium by such person shall be deemed to be receipt by the insurer. If the insurer alleges that the agent or broker is not authorised to receive such payments, the onus is upon them to prove such lack of authority⁶⁶. Unlike the common law, under the Insurance Act, the agent is presumed to have the authority to receive premiums

66. s.14A(2).

on behalf of the insurer and it is for the insurer to prove otherwise.

Once the premium is received by an agent on behalf of the insurer, he is required to deposit it with, or dispatch it by post to, the insurer within the prescribed time. Failure to do so is an offence under the Act⁶⁷.

While payment of the premium to an agent is deemed to be payment to the insurer, when a premium has to be returned to the insured, payment to an agent does not amount to payment to the insured and so the insurer must return it directly to the insured⁶⁸.

In relation to motor insurance, the provisions of the Insurance Act are supplemented by the Insurance (Assumption of Risks and Collection of Premiums) Regulations 1980 which provide that the premium for such insurance shall be deemed to have been received by the insurer if it is paid to an agent or a broker who is authorised by the insurer to accept the premium on its behalf, and a receipt for such premium has been issued⁶⁹. While the Act places the onus of proving an agent's lack

67. s.14A(4).

68. s.14A(5).

69. Regulation 4.

of authority upon the insurer, the Regulation refers to an agent or a broker who is 'authorised by the insurer' to accept such premium on its behalf. This implies a duty on the part of the insured to ensure that the agent or broker through whom the premium is to be paid has the authority to receive it.

Whilst the relevant provisions of the Act applies to all non-life insurance, the 1980 Regulations refers exclusively to motor insurance. To what extent the provisions of the latter will override the former or vice versa remains to be seen as neither has been interpreted or applied by the courts.

There are no parallel provisions in the Act in relation to the handling of premiums by agents in life insurance. This could be because of the potential difficulty of applying such a provision to a long-term policy. In non-life policies every renewal amounts to a new contract, so it is possible to postpone the commencement of cover until the premium is paid. This cannot be done with a life policy because the risk does not terminate at the end of each year even though the premium is paid annually or at other intervals. Such being the case there is also no reason to change the onus of proof in relation to the agent's authority to receive premiums.

Payment of the premium by the insured to someone who is

not authorised to receive it does not amount to payment to the insurer. The authority to receive such premium must come from the insurer. No amount of representation or holding out by the purported agent or sub-agent can amount to a representation or holding out by the insurer that such a person has the authority to receive the premium⁷⁰.

If an agent fails to transmit the premium which he has received from the insured to the insurer, the insurer is entitled to notify the insured of the agent's failure to do so. The agent cannot then sue the insurer for libel because the issue of such notice by the insurer to the insured is a qualified privilege between them⁷¹.

A del credere agent is liable to the insurer for the premiums on all the policies transacted by him irrespective of whether or not such premiums have been paid by the insured persons to him. In The Royal Insurance Group v David⁷², the appellant claimed a sum of (M)\$1,981.72 from the respondent as their del credere agent. The amount was for premiums due in respect of policies issued through the respondent. The respondent

70. Lee Cheng Oo v China Insurance Co., Op. cit. footnote 65.

71. Pacific and Orient Underwriters Sdn. Bhd. v Ong Tai Wah [1982] Malaysian CLJ 161.

72. [1976] 1 MLJ 128.

denied that he was liable for the premiums as the insured persons had not paid them to him. It was held that as a del credere agent, he was liable even though the insured persons had not paid the premiums to him.

2.1.7 Handling Notices of Loss/Claims

All policies contain provisions requiring the insured to give notice of loss or of any possible claims under the policy to the insurer in a prescribed manner; either within a stipulated time or as soon as possible. If such a notice is given by the insured through the agent, its validity depends on a number of factors.

If the agent has the authority to receive such notices on behalf of the insurer, then notice to an agent is notice validly given to the insurer. This is so even if the agent fails to communicate such notice to the insurer⁷³.

If the agent is not authorised to receive such notice or if the policy itself stipulates that such notice must not be given through an agent, then notice to an agent is only valid as a notice to the insurer provided the agent in fact communicates the notice to the insurer. The insured therefore takes the risk of the notice not being

73. Gale v Lewis (1846) QB 730.

conveyed to the insurer⁷⁴.

In Lee Seng Heng and Ors. v Guardian Assurance Co.⁷⁵, the plaintiffs sought to be indemnified by the defendants under a fire policy. One of the reasons given by the defendants in denying liability was that the plaintiffs had not given them a written notice as was required by the policy. The plaintiffs had in fact orally informed a clerk of the agent who had arranged the policy of the fire. They contended that this amounted to a sufficient notice to the insurer. It was held that at the time of the loss there was no valid policy because it had been previously effectively cancelled and so the question relating to the notice was of no relevance to the case. However the learned judge did consider the effect of such a notice if the policy had been in force at the time. According to him the policy clearly stipulated that the notice must be in writing. As the notice given to the agent's clerk was only a verbal notice, it was not as required by the policy. The learned judge then considered whether in the absence of a requirement that the notice be in writing, the notice to the agent's clerk was a valid notice to the insurer:⁷⁶

74. Shield v Scottish Assurance Corp. Ltd. (1889) 16R (Ct. of Sess.) 1014.

75. (1932) 1 MLJ 17.

76. Ibid. at p.21, per Murrison CJ.

[N]otice to the clerk was notice to the agent. But that is not all. It seems that even where notice to the agent is good, the assured takes the risk of the notice not being sent on (as was the case here) to the principal ...

The clause in the policy seems to insist on notice to the company itself but I think Gale v Lewis ((1846) QB 730) is a sufficient authority for saying that notice to the agent who issued the policy is notice to the principal. But again as the notice was never communicated to the principal this cannot avail the plaintiffs anything in view of the overriding principle just quoted above, namely that where (as here) the notice of loss was never communicated to the principal, the risk lies upon the insured.

With respect, it is difficult to follow the learned judge's line of reasoning. He seems to say that where the agent has the authority to receive the notice, notice to such agent is notice to the principal but the risk of the notice not being communicated to the principal is borne by the insured. While he correctly cited Gale v Lewis as authority for the fact that notice to an authorised agent is notice to the principal, he rather confusingly added to this the requirement that such notice must in fact be communicated by the agent to the principal. Notice to an authorised agent cannot be notice to the principal if it depends upon whether such a notice is in fact communicated by the agent to the principal.

2.2 The Liability of Agents

The existence of an agency relationship between the insurer and the agent does not always insulate the agent

from being made personally liable either to the insurer or to the insured or any other third party for his acts or omissions in the insurance transaction.

Being generally the agent of the insurer, an insurance agent is expected to have and to exercise the skill and diligence that can reasonably be expected from a person in that position in the conduct of the insurer's business. While a mere error of judgement on his part in the exercise of his duties may not be sufficient to make him personally liable to the insurer, negligence, want of skill or misconduct will make him liable to compensate his principal for all losses which result directly from such attributes⁷⁷.

In the absence of ratification by the insurer the agent is also personally responsible for any losses arising out of his unauthorised acts and an insurer can sue the agent for such losses⁷⁸. Similarly an agent is liable for any fraud or misrepresentation committed by him in respect of matters which fall outside the scope of his authority⁷⁹.

An insured who has suffered losses because of the unauthorised acts of the agent can either sue the agent

77. Contracts Act 1950, s.165.

78. s.164.

79. s.191.

directly or make him a third party in an action against the insurer. In Tan Boon Heng v Oriental Fire and General Insurance Co. Ltd.⁸⁰, the insurer sought a declaration that a policy issued by them to the appellant was void due to certain misstatements in the proposal form. The appellant alleged that if those facts were untrue, they were supplied by the insurer's agent who was aware that such facts were untrue. They applied for leave to issue a third party notice to the agent but this application was refused by the trial judge. On appeal the Federal Court granted leave. In the third party notice, the appellant claimed indemnity from the agent on the ground that he had failed in his duty to fill in the proposal form with the correct answers in that he, either knowing the correct answers or without inquiring the appellant about it, inserted incorrect answers which enabled the insurer to avoid the policy. As the issue in this case rested solely on whether a third party notice should be issued to the agent, no decision was made as to the agent's liability. The granting of the application to serve a third party notice to the agent is however an indication that the Federal Court recognised the possibility of the existence of a cause of action by the insured against the agent.

80. [1968] 1 MLJ 270.

If the agent promises on behalf of the insurer to issue a policy but fails to do so, it is the insurer not the agent who can be sued for specific performance. In Coopan Chetty v Bain⁸¹, the defendant as agent of the Netherlands India Sea Insurance Company, contracted to issue the plaintiff with a policy upon certain goods which was to be shipped on board 'The Alert'. The plaintiff shipped the said goods on the faith of this contract. After the ship had sailed the defendant refused to issue a policy on the ground that the ship was not seaworthy when she left port and that the earlier promise was made with the implied warranty that it was seaworthy. It was held that an action for specific performance against the agent could not succeed because it was in his capacity as the insurer's agent that he entered the contract and so the suit should have been brought against the insurer.

The liability of del credere agents to the insurer for premium on policies issued through them does not depend upon whether such premium has been paid by the insured to the agent. Provided that the sum involved is an ascertained sum (which is usually the case with premiums), the insurer is entitled to sue the agent directly for the amount due to them. There is no

81. [1862] Leic. 170.

necessity for the insurer to sue the insured first.
According to Gill LP in Royal Insurance Group v David:⁸²

[T]he obligation on the principal to sue the debtor first arises only when the amount claimed from a del credere agent is not an ascertained sum ... In the present case there was no dispute whatsoever as to the quantum of the premia claimed from the defendant...

An agent who fraudulently deceives or misleads a person into entering a contract of insurance can be guilty of a criminal offence under s.16A of the Insurance Act which reads:

Any person who, by any statement, promise or forecast which he knows to be misleading, false or deceptive, or by any fraudulent concealment of a material fact, or by the reckless making (fraudulently or otherwise) of any statement, promise or forecast which is misleading, false or deceptive induces or attempts to induce another person to enter or to offer to enter into any contract of insurance with an insurer shall be guilty of an offence ...

This provision which was introduced by the Insurance Amendment Act 1978⁸³ attempts to deal with some of the complaints that were prevalent against both insurance agents and brokers. By this provision the legislature has cast a very huge net to catch intermediaries who use questionable methods in selling policies. This provision

82. Op. cit. footnote 72 at p.129.

83. Act A432 of 1978.

is extremely wide in its scope as it covers not merely the actual making of such statements, promises or forecasts which are knowingly or recklessly misleading, false or deceptive but also fraudulent concealment of material information by such intermediaries. Proof of actual inducement is not necessary; an attempt to induce is sufficient. Neither does it matter whether or not the person concerned ultimately enters into the contract. It is sufficient if such a person makes an offer to do so.

3.0 Insurance Brokers

The insurance broker is a unique class of agent. Prima facie he is the agent of the insured, but he normally receives his remuneration from the insurer from whom he obtains cover for his client. Furthermore while the broker is the agent of the insured in negotiating and procuring an insurance policy, he is not invariably the insured's agent in all matters pertaining to the policy. In practice he has certain legal obligations to the insurer and in certain circumstances may even be the agent of the insurer.

3.1 The Broker's Authority

3.1.1 Procuring an Insurance Policy

In all matters pertaining to the placing of the

insurance, a broker is an agent of the insured⁸⁴. The authority of the broker to procure a policy for the insured generally implies an authority to solicit, negotiate and, depending on the terms of the agency, sometimes even to enter into a contract of insurance on behalf of the insured. In procuring a policy therefore a broker is subject to all the restrictions and obligations arising from his agency relationship with the insured. He is under a duty to obey the insured's instructions and to carry out the transaction with due skill and care.

3.1.2 Filling in the Proposal Form

The general rule in Newsholme Brothers that a person who fills in the proposal form is the agent of the insured, applies to brokers as it does to agents. As such, if in filling in the proposal form the broker fails to exercise the care and skill expected of him resulting in the insured being left without insurance cover, the broker should, logically be liable to his principal.

This however was not the view taken by the court in O'Connor v Kirby⁸⁵. The respondent who had just bought a new car consulted his broker to arrange insurance cover.

84. Anglo-African Merchants Ltd. v Bayley [1970] 1 QB 311 at p.322 per Megaw J.

85. [1972] 1 QB 90.

Inspite of being told by the respondent that he had no garage the broker wrote in the proposal form that the car would be kept in a garage. The respondent checked the proposal form before signing but failed to notice the mistake. When an accident occurred the insurer denied liability. The respondent sued the broker for breach of contract. He was awarded two thirds of the damages on the ground that he was contributorily negligent. The Court of Appeal allowed the broker's appeal on the ground that it was the respondent's duty to ensure that information given in the proposal form was correct. In failing to rectify the mistake, the respondent was the sole effective cause of the loss.

The broker in the above case seems to have breached at least two basic duties which he owed to his principal, ie. the duty to obey instructions and the duty to use skill and care in carrying out such instructions⁸⁶. The Court of Appeal however chose to put the insured's responsibility for a document which he has signed above all principles of agency.

In Malaysia, whether the position of a broker who fills in the proposal form is affected by s.44A seems to depend upon the relationship of the individual broker with the

86. Birds p.161, footnote 47.

insurer. The opening phrase to this section refers to 'a person who has at any time been authorised as its agent by an insurer'. Ordinarily an insurance broker is not authorised as its agent by the insurer and so the position of such a broker does not seem to be affected by s.44A. However, under the common law, according to Stockton v Mason⁸⁷, there can be instances where a broker acts as an agent for the insurer. Such a broker will certainly be 'a person who has at any time been authorised as its agent by the insurer' and will therefore fall within the scope of s.44A. If such a broker fills in a proposal form, he is thus an agent of the insurer by virtue of this provision.

Thus while an independent broker who fills in the proposal form for the insured does so as the insured's agent, a broker who has implied authority to act as an insurer's agent in certain circumstances, in filling the proposal form is by virtue of s.44A, the insurer's agent. This line of distinction is also crucial vis-a-vis non-disclosure. As an independent broker remains throughout as the insured's agent, disclosure to him does not amount to disclosure to the insurer. If disclosure is made to a broker who has implied authority to act on the insurer's behalf, disclosure to the agent is disclosure

87. [1978] 2 Lloyd's Rep. 430.

to the insurer.

3.1.3 Granting Temporary Cover

According to Lord Diplock in Stockton v Mason⁸⁸, it is a principle of law that a broker in non-marine insurance has implied authority to issue on behalf of the insurer or enter into as agent for the insurer, contracts of interim insurance. The insured in this case had changed his Ford Anglia for an MG Sports. His wife informed the broker about this over the telephone and the broker replied, 'That's alright, we will see to that'. An accident occurred while the MG was driven by the insured's son. The insurer denied liability on the ground that cover for the MG did not cover driving by the son. At the Court of Appeal it was held that the insurer was bound by the temporary cover granted by the broker.

The fact that the Court of Appeal implied the existence of such authority 'as a matter of law' and made no reference to any special facts in the case from which such authority could be implied, means that the principle as laid down by Lord Diplock is generally applicable. There may however be exceptional cases where such authority cannot be implied. In Stockton v Mason, the tripartite relationship between the particular insurer,

88. Ibid. at p.431.

insured and broker was already in existence prior to the telephone conversation. If a broker who had never transacted any business with a particular insurer promises his client to obtain a policy from that insurer, it would be unreasonable to hold that the broker had implied authority from that insurer to grant temporary cover on their behalf.

3.1.4 Handling Premiums

Payment of the premium to the broker is not ordinarily payment to the insurer unless as is usually the case, the broker has authority to collect the premiums on behalf of the insurer or unless there is a holding out by the insurer that the broker acts as their agent for such purpose.

In Malaysia the provisions relating to the handling of premiums by agents apply to brokers as well⁸⁹.

3.2 Conflict of Interest

Being generally in a fiduciary relationship with the insured, the broker owes several stringent duties to the insured. One of these is that he must not put himself in a position where there would be a conflict of interest.

89. Supra. pp.280 - 285.

While acting for the insured, the broker should not at the same time act for the insurer without the insured's express permission⁹⁰. If he does so, the broker would be acting in breach of his duty to the insured who is his real principal.

In North and South Trust v Berkeley⁹¹, the plaintiffs requested a Lloyd's broker to procure insurance for goods in transit. The broker placed the insurance with a syndicate of which the defendant was a member. When a claim was made under the policy the underwriters instructed the broker to obtain the assessor's report. The plaintiffs took action to force the broker to show them the report. It was held that the broker in acting on behalf of the insurer in obtaining the report had been in breach of his duty to the insured. The learned judge however rejected the insured's application for the report and upheld the seal of confidentiality between the broker and his second principal, the insurer.

3.3 The Liability of Brokers

If the broker's failure to exercise care and skill in carrying out the insured's instructions results in losses

90. Anglo-African Merchants Ltd. v Bayley
Op. cit. footnote 84.

91. [1971] 1 WLR 470.

to the insured, the insured can sue the broker for damages for breach of contract as well as for the tort of negligence. The broker may for instance be liable for breach of duty towards the insured if he advises the insured to insure with the wrong insurer. In Osman v Moss⁹², the insured was of Turkish origin whose ability to understand English was extremely limited. On the advice of his broker he procured a motor vehicle insurance from a company which was well known within the insurance industry to be financially unstable. When the company was subsequently wound-up, the broker wrote to the insured advising him to take up a new policy but the insured took no action. An accident occurred whilst the insured was without any effective cover. It was held that the broker was liable to the insured for breach of contract as well as in tort for the breach of a duty of care⁹³.

Similarly if the insured is left without effective cover because the broker had failed to disclose to the insurer information which had been given to him by the insured, the broker may be liable to the insured. In Warren v Sutton & Co.⁹⁴, the insured instructed his broker to

92. [1970] 1 Lloyd's Rep. 313.

93. It is not clear from the decision how much weight was given by the court to the fact that the insured spoke little English and so could not have effectively responded to the letter.

94. [1976] 2 Lloyd's Rep. 276.

extend the cover of his motor vehicle policy to cover his friend who was driving to France with him. The broker failed to disclose to the insurer the friend's appalling driving records and criminal convictions. It was held by the Court of Appeal that in making the false representations to the insurer the broker had acted in breach of his duty towards the insured.

If the broker is instructed to procure a particular type of policy but fails to do so resulting in his client being without cover, the broker will also be liable to the insurer. In Fraser v Furman Productions⁹⁵, the defendant had asked their broker to effect an employer's liability policy but the broker failed to do so. Damages having been awarded in favour of an employee and against the defendant for negligence, the defendant claimed indemnity from the broker. It was held that the broker was liable in spite of their contention that even if they had carried out the instruction the insurer could have avoided liability because the defendant had been in breach of a condition precedent. According to the court, even though the policy if procured would have been a voidable one, the insurer might not have avoided it.

95. [1967] 3 All ER 57.

The broker's liability to the insured for misrepresentation and non-disclosure must be considered at two levels, ie. misrepresentation and non-disclosure at the time when the broker fills in the proposal form and misrepresentation and non-disclosure at other times. Where the broker fills in the proposal form and in so doing fails to disclose or misrepresents a particular fact, then according to the decision in O'Connor v Kirby⁹⁶, it is the insured's duty to ensure that the information given in the proposal form is correct. If the insured fails to do so, any non-disclosure or misrepresentation in the proposal form is his sole responsibility. If the misrepresentation or non-disclosure is made by the broker at any other stage in the course of procuring a policy, the broker may be liable to the insured if as a result of such misrepresentation or non-disclosure the insured is left without cover. In McNealy v Pennine Insurance Co.⁹⁷, a property repairer who was also a part-time musician was advised by his broker to insure his car with the defendant company which offered attractive rates of premium. The defendant however would not insure certain categories of persons including 'whole or part-time musicians'. A claim under the policy was refused by the

96. Op. cit. footnote 85.

97. [1978] 2 Lloyd's Rep. 18.

defendant on the ground that the insured had not disclosed the fact that he was a part-time musician. It was held by the Court of Appeal that it was the broker's duty to use all reasonable care to ensure that the insured was properly covered. The fact that the broker himself did not know that the insured was a part-time musician did not absolve him from blame as in not going through the categories of excluded persons with the insured, the broker had failed in his duty.

In Malaysia, the provisions of s.16A of the Insurance Act, which make it an offence for an intermediary to make misleading statements, promises or forecasts to induce others to enter into a contract of insurance, is as applicable to brokers as it is to agents⁹⁸.

While the broker can sue the insurer on behalf of the insured to enforce a contract of insurance, the insured cannot sue the broker for indemnity under the contract of insurance itself. In Chua Yew Phong v AS Yeo⁹⁹, the defendant who was sued for professional negligence as a solicitor, served a third party notice on his broker alleging that they were liable for damages arising out of the professional negligence suit, under a professional

98. Supra. pp.291 - 292

99. [1966] 2 MLJ 257.

indemnity policy procured through them. The broker applied to have their name struck off as they were not the underwriters of the policy, but merely a firm of brokers. In granting their application, MacIntyre J said:¹

The business of insurance brokers is to act as intermediaries between the insurance companies and the prospective policyholders. In effecting these contracts, the insurance brokers constitute themselves as agents of the policyholders and in that capacity may sue the underwriters of their clients to enforce a contract of indemnity; but that right to sue does not render them liable for indemnity under the contract with the underwriters.

1. Ibid. at p.258.

